

**The Federal Democratic Republic of Ethiopia:
Selected Issues and Statistical Appendix**

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INTERNATIONAL MONETARY FUND
THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Selected Issues and Statistical Appendix

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Approved by the African Department

August 26, 2004

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Ethiopia: Basic Data 1/

Area: 1,221,900 square kilometers
 Population, 2004 estimate: 71.1 million
 Population, 1993/94 - 2003/04 average annual growth: 2.8 percent
 GNI per capita, *World Bank Atlas* method, 2002 estimate: US\$100

	1998/99	1999/2000	2000/01	2001/02	2002/03
National accounts					
(In millions of birr, unless otherwise specified)					
GDP at current market prices	48,803	53,190	54,211	51,933	57,077
GDP at factor cost at constant (1980/81) prices	15,294	16,112	17,354	17,632	16,941
(annual percentage change)	6.0	5.4	7.7	1.6	-3.9
GDP deflator (annual percentage change)	3.3	2.9	-6.3	-6.3	14.5
(In percent of GDP at current market prices)					
Gross domestic expenditure	114.8	115.0	114.7	117.9	119.4
Consumption	97.9	99.1	96.9	97.5	99.0
Gross capital formation	16.9	15.9	17.8	20.4	20.5
Net exports	-14.8	-15.0	-14.7	-17.9	-19.4
Gross savings	9.1	10.7	14.2	14.7	15.8
Prices					
(Annual percentage change, unless otherwise specified)					
Consumer price index (annual average)	4.8	6.2	-5.2	-7.2	15.1
Consumer price index (end of period)	12.3	0.3	-11.4	-1.0	23.5
Terms of trade, goods (- deterioration)	-15.9	-33.9	-3.4	-10.9	-10.0
Exchange rates					
Ethiopian birr per U.S. dollar (period average)	7.53	8.15	8.34	8.15	8.34
Nominal effective exchange rate (-depreciation; end of period)	-8.6	3.1	5.9	-7.3	-10.1
Real effective exchange rate (- depreciation; end of period)	0.7	0.4	-12.7	-7.6	6.0
Central government finance					
(In millions of birr, unless otherwise specified)					
Total revenue and grants	10,387	11,222	12,805	12,834	15,702
Grants	1,614	1,724	2,628	2,425	4,553
Total expenditure and net lending 2/	15,454	17,184	15,786	17,651	20,495
Recurrent	10,528	13,742	10,379	10,550	13,527
Development and net lending	4,926	3,442	5,003	6,130	6,313
Special program	0	0	404	971	655
Overall balance 2/					
(including grants)	-5,067	-5,961	-2,982	-4,818	-5,526
(excluding grants)	-6,681	-7,685	-5,609	-7,243	-10,079
Overall balance (in percent of GDP) 2/					
(including grants)	-10.4	-11.2	-5.5	-9.3	-9.7
(excluding grants)	-13.7	-14.4	-10.3	-13.9	-17.7

Ethiopia: Basic Data (concluded)

	1998/99	1999/2000	2000/01	2001/02	2002/03
Money and credit					
	(Annual percentage change)				
Domestic credit 3/	8.8	33.2	2.9	-0.6	2.6
Government (net)	4.8	27.9	-0.9	2.9	5.7
Other sectors	4.1	5.3	3.8	-3.5	-3.2
Money and quasi-money (M3)	5.9	14.0	9.5	12.3	10.4
Balance of payments					
	(In millions of U.S. dollars, unless otherwise specified)				
Current account balance	-510	-335	-233	-347	-310
Excluding official transfers (net)	-723	-626	-629	-781.69	-850.44
Exports, f.o.b.	484	486	463	452	483
Imports, f.o.b.	-1,558	-1,611	-1,557	-1,696	-1,940
Trade balance	-1,074	-1,125	-1,094	-1,244	-1,457
Services (net)	114	149	137	153	167
Income (net)	-52	-60	-51	-40	-55
Current transfers (net)	502	701	775	783	1,035
Capital and financial account (net) 4/	37	-31	169	652	472
Foreign direct investment (net)	136	51	52	0	14
Official long-term loan (net)	-263	-10	194	489	353
Others 4/	164	-72	-77	164	104
Overall balance	-473	-366	-64	305	161
Current account balance (in percent of GDP)					
(including official transfers)	-7.9	-5.1	-3.6	-5.7	-4.7
(excluding official transfers)	-11.2	-9.6	-9.7	-12.9	-12.8
Gross official international reserves (end of period)					
In millions of U.S. dollars	434	349	337	664	931
In months of next year's imports	2.7	2.2	2.0	3.3	3.8
External debt					
Stock of external debt (end of period) 5/ 6/	5,309	5,452	5,614	6,125	6,551
(in percent of GDP)	82.1	83.6	86.3	100.8	98.5
External debt service 5/ 7/					
(in percent of export of goods and services)	63.3	52.3	22.7	17.0	14.9

Sources: Ethiopian authorities; and IMF and World Bank staff estimates.

1/ Beginning 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30 except for money and credit.

2/ Including special programs.

3/ In percent of beginning-of-period broad money stock.

4/ Including errors and omissions.

5/ Public medium- and long-term debt, including to the Fund.

6/ Before 1999/2000, post-debt relief; thereafter, pre-debt relief.

7/ Before debt relief; on an accrual basis.

I. INTRODUCTION

1. This selected issues paper provides further background information on four issues emerging from the Article IV consultation, namely: an assessment of the attainability of the authorities' target for real GDP growth under a scenario which includes significantly higher external aid flows for achieving the Millennium Development Goals (MDGs), an assessment of the potential impact of higher external aid flows within the context of pursuing the MDGs on Ethiopia's tradable goods sector, an overview of the experience with the decentralization of fiscal powers to regions and districts (*woredas*), and an overview of the development of the financial sector.

2. Real GDP growth averaged 4.0 percent during 1991/92-2003/04, which was significantly higher than that experienced under the military dictatorship (the Derg regime). Most of this growth originated from the accumulation of factors of production (capital and labor), with total factor productivity contributing only 0.7 percentage points. Potential GDP growth during this period is estimated to be about 4½ percent. Raising the level of growth to 7 percent annually, as targeted under the authorities' medium-term scenario for achieving the MDGs, would therefore represent a substantial improvement over the experience of the past 13 years. Achieving the targeted growth rate in the context of a significant scaling-up of external aid flows would be possible, provided that the increase in resource availability is accompanied by a marked acceleration in the implementation of reforms aimed at supporting agricultural production, private sector development, and exports.

3. According to the "Dutch disease" hypothesis, foreign aid represents a real transfer of tradable goods, which could increase the demand for, and the relative prices of, nontradable goods (a real exchange rate appreciation), causing a relative reduction in the size of the tradable goods sector. There is, however, no evidence that aid flows in the post-1991 period (i.e. following the overthrow of the Derg regime) caused a real appreciation, nor adversely impacted noncoffee exports. However, given that the resource flows required to achieve the MDGs would be significantly higher than in the past, upward pressure on wage and price levels would be expected to cause a real exchange rate appreciation, and it would thus be prudent to implement policies to counter such pressure. There are two main routes through which the demand-driven pressures on the exchange rate can be moderated: channeling part of the increased domestic demand abroad via further opening-up of the economy to foreign trade; and meeting part of the increased demand by increasing the supply of domestically produced goods and services by boosting productivity and cost efficiency.

4. The possibility of significantly higher aid flows to support achievement of the Millennium Development Goals (MDGs), underscores the need to develop the capacity of fiscal institutions in order to improve poverty-reduction outcomes. Advancing structural reforms in the areas of fiscal decentralization, public expenditure management (PEM) and revenue administration will represent key aspects of the broader reform agenda. In addition, pursuing these reforms will support decentralized democratic governance, strengthen budgeting capacity, and build institutions that foster private sector development.

II. ASSESSING THE IMPLICATIONS FOR GROWTH OF ACHIEVING THE MDGs¹

A. Introduction

5. **Recent assessments indicate that based on current trends, most MDGs will not be met by most countries, and that while the income poverty goal is likely to be achieved on a global level, African countries will fall well short of this goal.**² Preliminary and partial analysis by the World Bank shows that on current trends, Ethiopia will only achieve the MDG goal for the primary school enrollment ratio.

6. **Ethiopia's PRSP (the Sustainable Development and Poverty Reduction Program – SDPRP) presents sectoral targets and spending programs, that are considered to be consistent with achieving the income poverty MDG, while also making progress towards achieving the other MDGs.**³ These programs, however, reveal a significant gap between available resources and those required for achieving these objectives. For instance, the estimated costs of fully implementing the SDPRP during 2002/03-2004/05 (including the cost of the Food Security Program), are 138 percent of 2002/03 GDP, while the government's proposed medium-term expenditure framework allocates 65 percent of 2002/03 GDP to poverty-related expenditure.

7. **According to projections by the Ethiopian authorities, real GDP growth should average 5.7 percent per year to 2015 in order to achieve the income poverty goal of halving the number of people living in poverty.** However, based on an assumption of significantly higher external aid flows and implementation of the reforms identified in the SDPRP, the authorities are targeting average annual real GDP growth of about 7 percent. Under this scenario, the authorities assume that external financing and grants would gradually rise from about 11 percent of GDP in 2003/04 to 22 percent by 2015/16. Such higher resource flows would allow per capita poverty spending (in U.S. dollars) to rise from about \$20 in 2003/04 to about \$78 by 2015/16, while the ratio of public expenditure to GDP would rise from 31 percent in 2003/04 to 42 percent by 2015/16.

8. **The purpose of this analysis is to assess the implications for real GDP growth of a significant increase in the flow of external financing and grants.** Section B of this paper presents an analysis of the sources of growth during 1991/92-2003/04, as well as an assessment of potential GDP growth, while Section C assesses the implications for achieving average annual real GDP growth of 7 percent.

¹ Prepared by Lodewyk J. F. Erasmus (AFR).

² See Draft Global Monitoring Report 2004 – Policies and Actions for Achieving the MDGs and Related Outcomes.

³ See Ethiopia – Sustainable Development and Poverty Reduction Program.

B. Sources of Growth

9. **Reforms aimed at transforming the Ethiopian economy from a centrally planned economy under the Derg regime (1974-1991) to a market-oriented economy were launched by the current government in 1991.** Real GDP growth (at factor cost) during 1991/92-2003/04 averaged 4.0 percent per year, while real GDP per capita growth averaged 1.1 percent per year.

10. **While this represents a significant improvement on real GDP growth of 2.8 percent per year, compared with the period of the Derg regime, growth remained volatile.** For example, the standard deviation of real GDP growth in Ethiopia during 1981–2002 was 6.5 relative to a mean growth rate of 2.8 percent, which was significantly higher than in neighboring countries such as Kenya (2.2), Tanzania (2.4), Uganda (3.6), and Zambia (4.6). Econometric analysis suggests that the volatility of real GDP growth in Ethiopia is largely due to the continued dependence of agricultural production (which accounted for about half of real GDP during 1981-2002) on rainfall.

11. **A simple regression framework is used to explore the relationship between the level of real GDP, average annual rainfall, and the terms of trade for the period 1974–2002.** The results suggest that rainfall and a trend explain about 94 percent of the variance in the level of real GDP. Fluctuations in average annual rainfall in particular appear to have a substantial impact on real GDP, with a change of 1 percent in average annual rainfall leading to a change in real GDP of 0.3 percent in the next year. While the terms of trade had the correct sign, it was not statistically significant.

Table II.1. Ethiopia: Estimating the Impact of Exogenous Variables on Real GDP

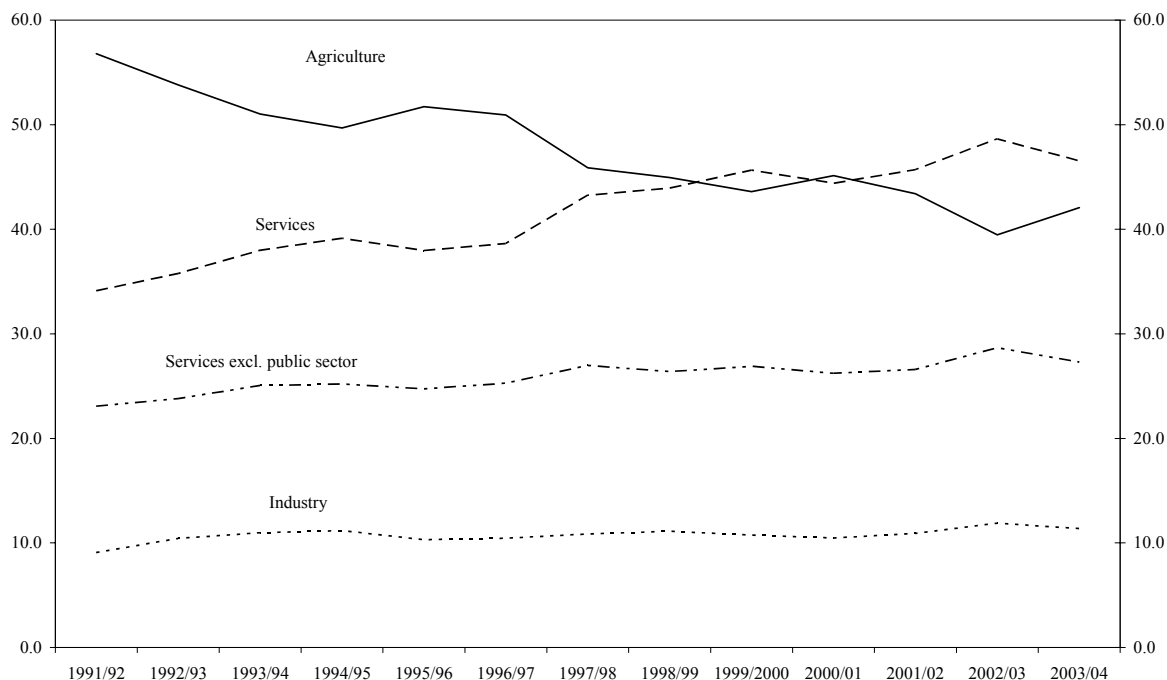
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.713605	0.605934	11.07976	0
TOT(-1)	0.02484	0.039268	0.632572	0.5333
RAIN(-1)	0.317317	0.086526	3.667315	0.0013
T	0.022484	0.002357	9.538986	0
ADT	-0.001742	0.002197	-0.792908	0.4359
R-squared	0.942486	Mean dependent var		9.3372
Adjusted R-squared	0.932484	S.D. dependent var		0.181176
S.E. of regression	0.047077	Akaike info criterion		-3.1137
Sum squared residual	0.050973	Schwarz criterion		-2.8758
Log likelihood	48.59109	F-statistic		94.22635
Durbin-Watson statistic	1.615758	Prob(F-statistic)		0

Source: Staff calculations.

12. **With the achievement of higher growth during 1991/92-2003/04, the structure of the Ethiopian economy changed noticeably (Figure II.1).** The contribution of agriculture

to real GDP declined from 57 percent in 1991/92 to 42 percent in 2003/04, and that of services rose from 34 percent to 47 percent. However, the contributions to real GDP by industry and private services (i.e. excluding the public sector) remained essentially unchanged.

**Figure II.1. Ethiopia: Sectoral Contribution to Real GDP
(In percent of GDP)**



13. **Furthermore, growth in agricultural production and the services sectors continued to be important for real GDP growth, while growth in the valued-added of industry did not make an important contribution to overall output growth (Table II.2).**

14. **On the demand side of the economy, growth in consumption expenditure, and particularly private consumption, was the most important source of real GDP growth, while the external sector contributed only marginally to real growth (Table II.2).**

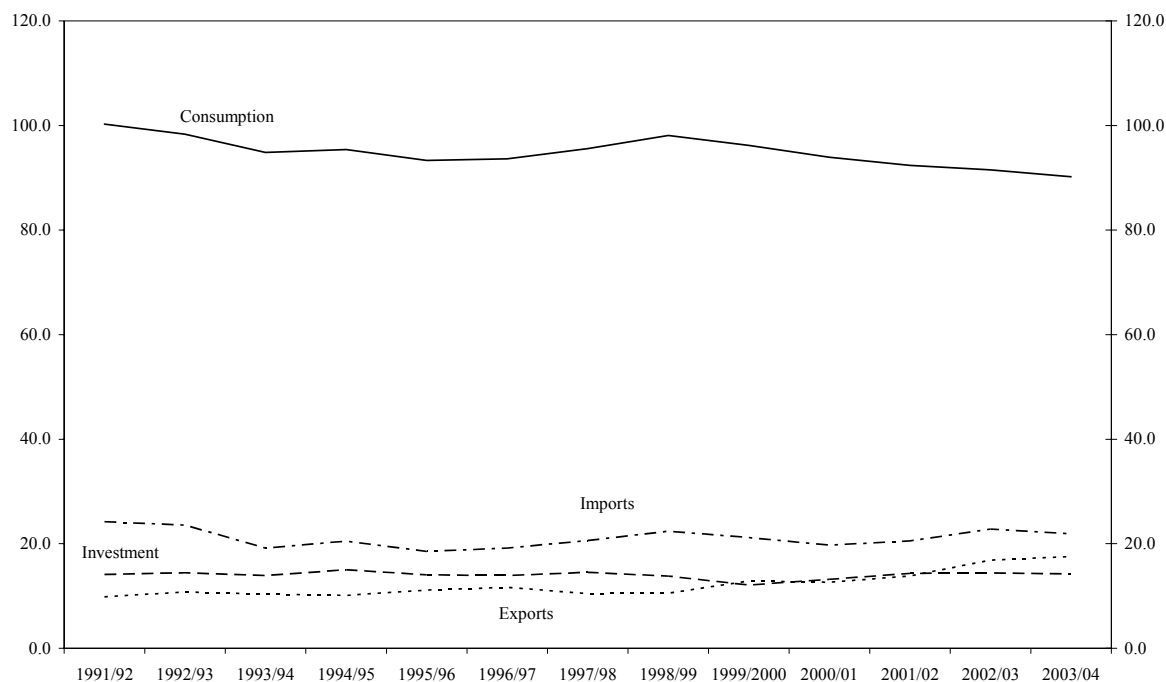
15. Reflecting the above, consumption expenditure continued to account for a significant proportion of real GDP (Figure II.2).

Table II.2. Ethiopia: Contribution to real GDP Growth

	1991/92-2003/04
Agriculture	1.0
Industry	0.5
Services	2.5
Services excluding public sector	1.3
Real GDP at factor cost	4.0
Consumption	5.2
Private	4.4
Public	0.9
Investment	0.9
Private	0.4
Public	0.5
Resource gap	0.2
Exports	1.3
Imports	-1.1
Real GDP at market prices	6.3

Source: Staff calculations.

**Figure II.2. Ethiopia: Contribution to GDP
(In percent of GDP)**



16. A growth accounting framework was also applied in order to decompose the growth rate of real GDP into contributions from the accumulation of factor inputs (capital and labor), and improvements in total factor productivity (TFP).

The shares of capital and labor are generally derived, either from national accounts, or through econometric estimation. Given data limitations, the shares of capital and labor in real GDP are assumed to be 0.35 and 0.65 respectively,

which is consistent with the estimates reported for many developing countries. Of the average annual growth rate of 4.0 percent in real GDP during 1991/92-2003/04, growth in physical capital contributed 1.4 percentage points, labor growth contributed 2.0 percentage points, and the remaining 0.7 percentage points was contributed by TFP (Table II.3).

Table II.3. Ethiopia: Sources of Growth and Potential Real GDP Growth (In percent)

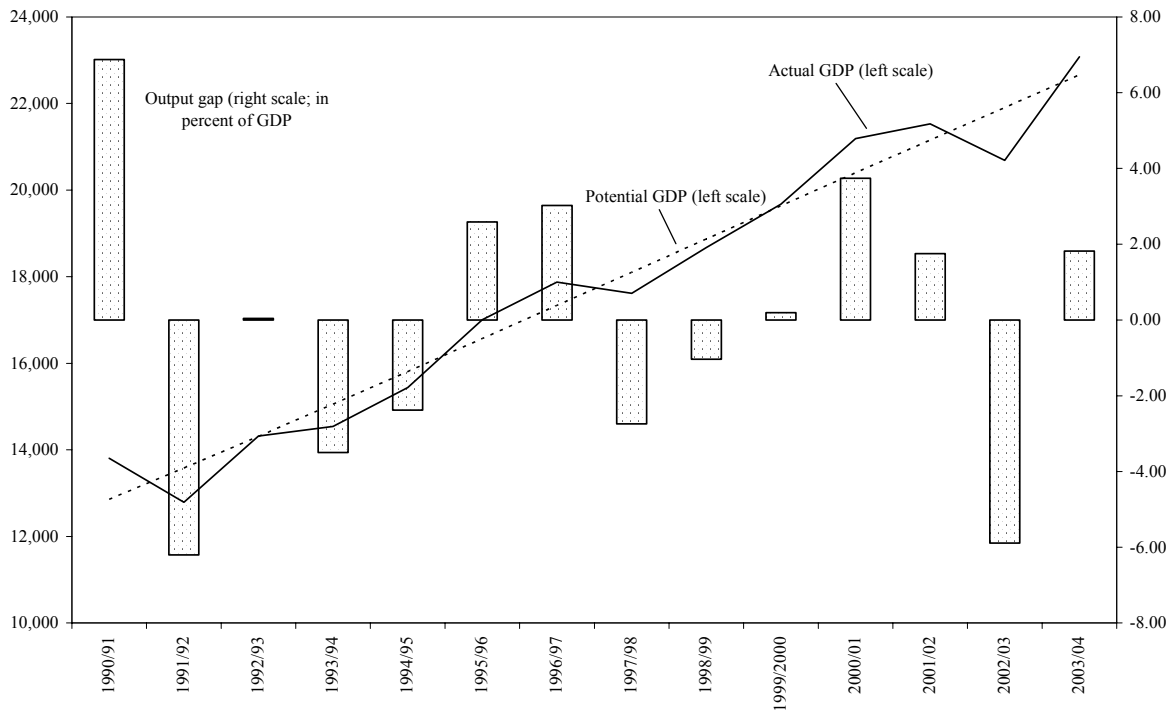
	1991/92-2003/04
Growth accounting	
Real GDP at factor cost	4.0
Capital stock	1.4
Labor	2.0
Total factor productivity	0.7
Potential GDP growth	
HP filter	4.5
Production function	4.4
Capital-output ratio	4.4

Sources: Ethiopian authorities; and staff estimates and projections.

17. Potential GDP growth during 1991/92-2003/04 is assessed through the application of three methodologies, namely an HP filter, the production function

approach, and the capital-output ratio approach. In the context of the real GDP series, the HP filter derives a trend output rate such that it minimizes a weighted average of the gap between actual output and trend output (Figure II.3). While the principal advantage of this technique is its simplicity, the major shortcoming is that it does not have an economic basis in the sense that the estimated productive limits of the economy are not based on the available factors of production.

**Figure II.3. Ethiopia: Actual and Potential Output
(In millions of birr)**



18. **The production function models output as a function of capital, labor and total factor productivity – the functional form is a Cobb-Douglas production function.**

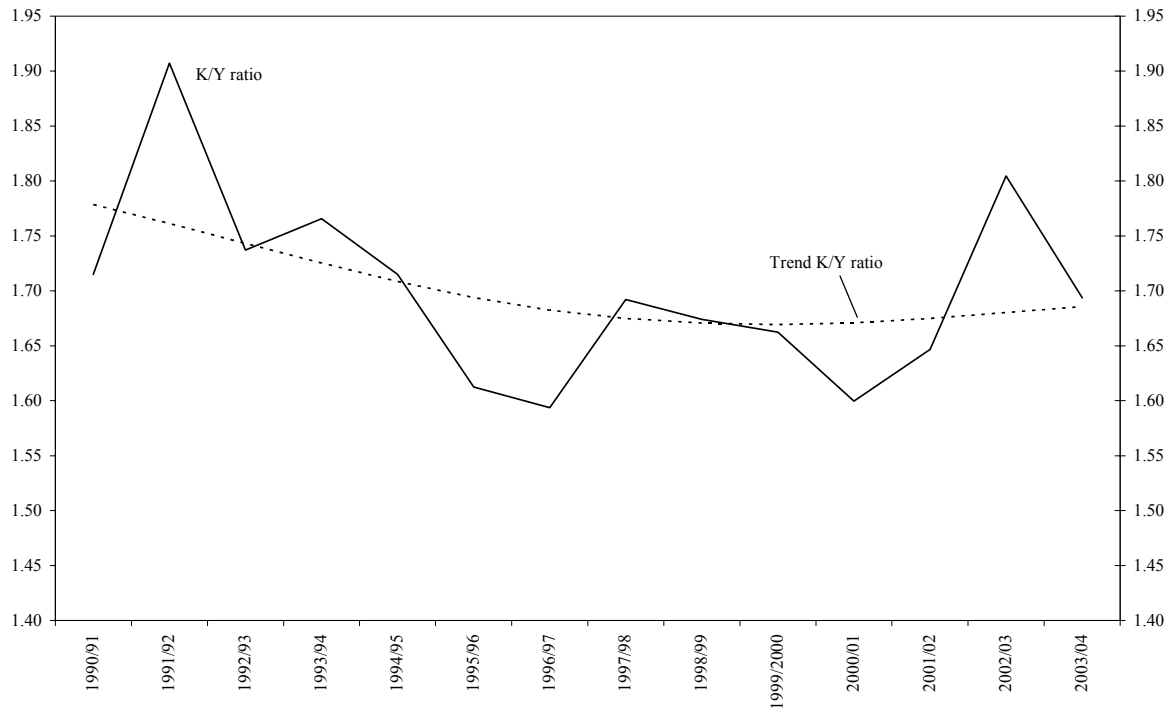
- $GDP = AK^\alpha L^{(1-\alpha)}$, and thus
- $\Delta Y / Y = \Delta A / A + \alpha \Delta K / K + (1 - \alpha) \Delta L / L$

19. **Empirically, the practice is to estimate potential output as the level of output associated with a normal rate of capacity utilization, labor input at the level of the natural rate of unemployment, and total factor productivity (TFP) at its trend level.** In practice, this involves the following steps: (i) TFP growth is derived as the difference between the observed real GDP growth and the weighted sum of capital and labor growth; (ii) trend growth rates are computed for labor and TFP; and (iii) potential GDP growth is

estimated as the sum of potential TFP growth and the weighted sum of the growth in capital and potential labor.

20. **The underlying assumption of the capital-output ratio approach is that developing countries are characterized by excess labor (although there may be shortages in categories of skilled labor), and a lack of infrastructure and capital.** The normal capacity of the economy is thus determined by dividing the capital stock by trend productivity, as measured by the trend capital-output ratio. The trend capital-output ratio reflects technology, the composition of capital, and the quality of capital and labor. Generally, it takes a long time to significantly change the composition and quality of capital and labor, and the trend capital-output ratio therefore does not change much in the short run (Figure II.4).

Figure II.4. Ethiopia: Capital-Output Ratio



21. **According to the above analysis, potential GDP growth during 1991/92-2003/04 thus amounted to about 4.4 percent per year (Table II.3).**

C. Assessing the Authorities' MDG Growth Scenario

22. **The Ethiopian authorities consider that a doubling of external aid flows and determined implementation of the reforms detailed in the SDPRP would significantly enhance Ethiopia's ability to achieve the MDGs.** Specifically regarding the income

poverty MDG, the authorities consider that raising the level of external aid and implementation of the identified reforms would allow average annual real GDP growth to rise to a level of 7 percent. Such a growth performance would be consistent with the high case scenario presented in the authorities' first annual progress report (APR) of the SDPRP, but would constitute a substantial improvement over the growth performance during 1991/92-2003/04 (Table II.4). The authorities' medium-term projection is premised in particular on a significant increase in agricultural output growth to an annual average of 7.5 percent from 2.2 percent during 1991/92-2003/04.

Table II.4. Ethiopia: Assessing Medium-term Real GDP Growth

	Actual 1991/92-2003/04	Authorities' Projection	
		ICOR 2004/05-2020/21	Real value added 2004/05-2020/21
Production approach			
Real GDP at factor cost	4.0	6.7	7.0
Agriculture	2.2		7.5
Nonagriculture	5.8		6.6
Real per capita GDP	1.1		4.2
Nominal investment/Nominal GDP at market prices			
Total	16.8		31.4
Private	9.1		15.6
Public	7.7		15.8
Growth accounting			
Real GDP at factor cost	4.0		7.0
Capital stock	1.4		3.0
Labor	2.0		2.3
TFP	0.7		1.7

Sources: Ethiopian authorities; and staff estimates and calculations.

23. **To assess the impact of such a scenario on real GDP growth, the staff was guided by the pattern of expenditure detailed in the “Extended PRSP” scenario in the Public Expenditure Review of the World Bank to develop a long-term profile for public recurrent and capital spending.** This projects an increase in the ratio of public investment to GDP to an average of 15.8 percent during 2004/05-2020/21 compared with 7.7 percent during 1991/92-2003/04. Furthermore, private sector investment is expected to be positively affected by the implementation of the authorities' reform program; as a working assumption, it is assumed that the ratio of private to public investment would be the same as that projected under the baseline scenario.

24. Utilizing two approaches, namely the Incremental Capital-Output Ratio (ICOR) approach, and a growth accounting approach, **the staff's calculations show that achieving the authorities' target for raising the level of average annual real GDP growth to 7 percent would require, in addition to the projected increase in public sector**

investment, also a substantial increase in private sector investment, as well as in total factor productivity.⁴

25. **The ICOR approach is based on the assumption that economic growth depends on investment as a share of GDP, adjusted by a factor which represents the quality of investment.** Thus:

- $g = (I/Y) / \mu$,
- where g is real GDP growth, I is total investment, Y is real output, and μ is the quality of investment, or the incremental capital-output ratio. The ICOR represents the units of additional capital that are required to yield a unit of additional output.

26. **Assuming the same ICOR as that implied in the baseline scenario, and applying the projected level of total investment, as described above, yields an average annual growth rate in real GDP at factor cost of 6.7 percent during 2004/05-2020/21.** In terms of the growth accounting framework, and accounting for the projected increases in capital and labor, the contribution to real GDP growth from TFP would have to equal 1.7 percentage points in order to achieve average annual growth of 7 percent. The projected capital stock is calculated using the projection for gross investment, while for labor, it is assumed that the labor force continues to grow at the trend growth rate, and that education (as measured by average years of schooling) would increase at an average rate of 5.1 percent per year between 2000 and 2021, a rate that is comparable to historical growth rates.

27. **The above conclusion regarding the attainability of the authorities' target for real GDP growth depends critically on significant progress with the implementation of the authorities' reform program.** This assessment is consistent with empirical research which shows that the effect of aid on growth depends on the quality of institutions and policy.⁵ Thus, raising average annual real GDP growth to 7 percent over the medium term from 4.0 percent during 1991/92-2003/04 would require, in addition to raising the level of external aid, significant progress with the implementation of key structural reforms in agriculture, private sector development, financial sector development, and external trade.⁶

⁴ See The Federal Democratic Republic of Ethiopia – Staff Report for the 2004 Article IV Consultation and Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility.

⁵ See Burnside and Dollar.

⁶ For details of required reforms, see reference noted in 4 above.

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III. FOREIGN AID INFLOWS AND THE ISSUE OF DUTCH DISEASE⁷

28. In light of the potentially large inflows of foreign financing needed to achieve the MDGs, this chapter seeks to assess the historical relationship between foreign aid and the performance of the external sector in Ethiopia in order to establish whether foreign aid inflows have had an adverse effect on the tradable goods sector in the past – a phenomenon commonly referred to as "Dutch disease."

A. Theoretical Considerations

29. According to the "Dutch disease" hypothesis, foreign aid represents a real transfer of tradable goods, and tends to increase the demand for, and the relative prices of, nontradable goods (a real exchange rate appreciation). The latter could lead to a relative reduction in the size of the tradable goods sector. Given that foreign trade is viewed as an engine for growth in developing countries, aid-driven reductions in the tradable goods sector can block the path to export-based growth even though the total amount of resources available for consumption (temporarily) increases.

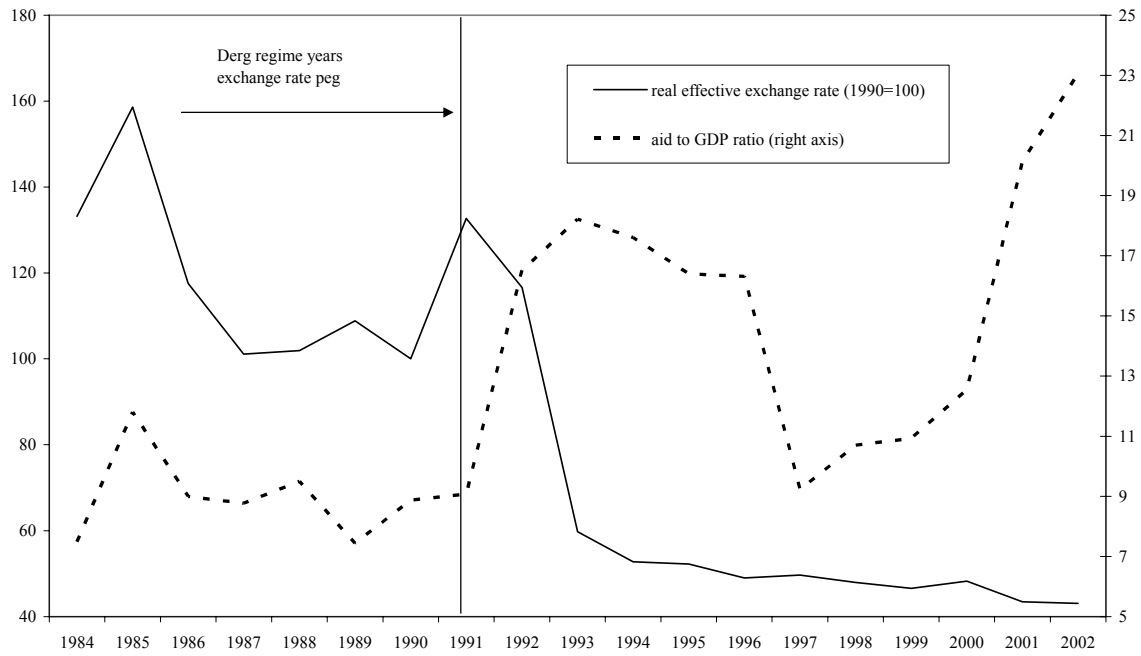
B. Empirical Evidence

30. The focus of the analysis of the historical relationship between aid and the external sector was on the real exchange rate and noncoffee merchandise exports.⁸ The charts below show the real exchange rate, market share developments, and the growth rate of noncoffee exports starting from 1984—the first year for which data on coffee exports is available. A structural break in the behavior of the variables is clearly evident in 1991—the year in which the Derg regime was overthrown. The pre-1991 period is characterized by a fixed nominal exchange rate, low levels of foreign aid, and declining market shares of Ethiopian exports. Aid inflows during that period appear to be strongly and positively correlated with the behavior of the real exchange rate, suggesting that aid was likely spent on domestic consumption. The post-1991 period is characterized by exchange rate flexibility, structural reform, higher and rising levels of aid, and increasing market shares of Ethiopian exports. Unlike in the pre-1991 period, there is no positive correlation between aid and real exchange rate appreciation. On average, the growth rate of Ethiopia's noncoffee exports has exceeded during the reform period the growth rate of world imports but was adversely affected by the recurrent droughts. The developments in the latter period thus suggest that aid must have been used more productively, essentially to expand the production possibilities set, while the level of the exchange rate does not suggest a competitiveness problem in Ethiopia's traded goods sector.

⁷ Prepared by Yuri Sobolev (PDR) and Ayumu Yamauchi (AFR).

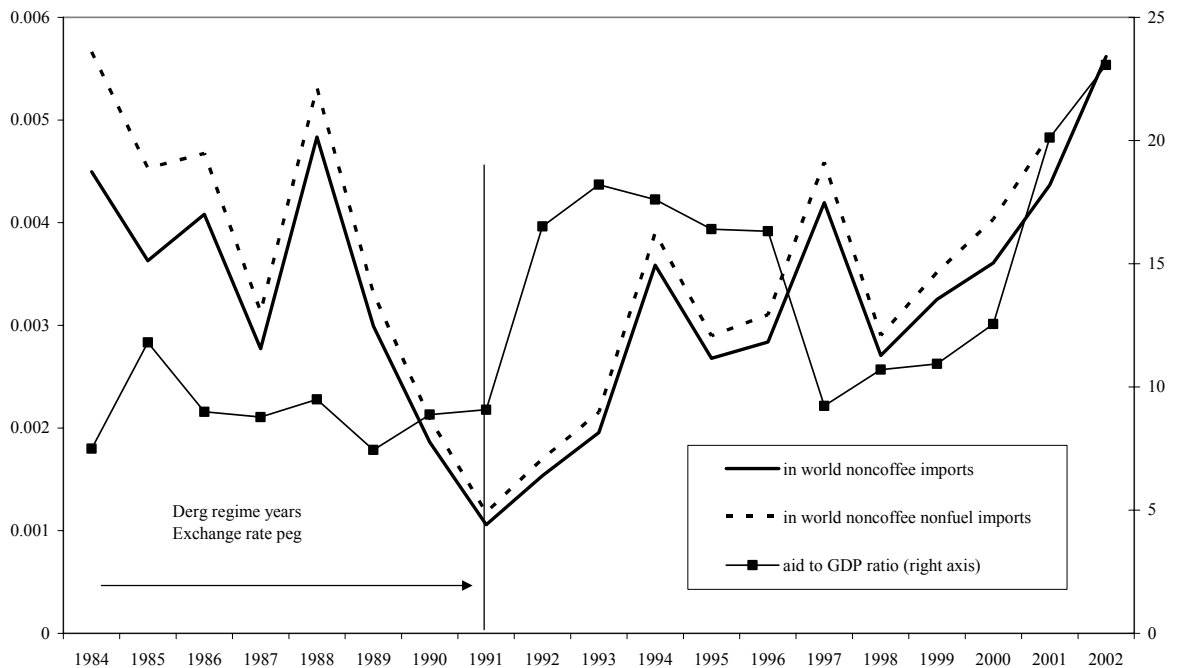
⁸ Coffee exports are driven by international prices and like other primary-sector exports would be much less affected by real appreciation of the exchange rate.

Figure III.1. Real Effective Exchange Rate vs. Aid Inflows



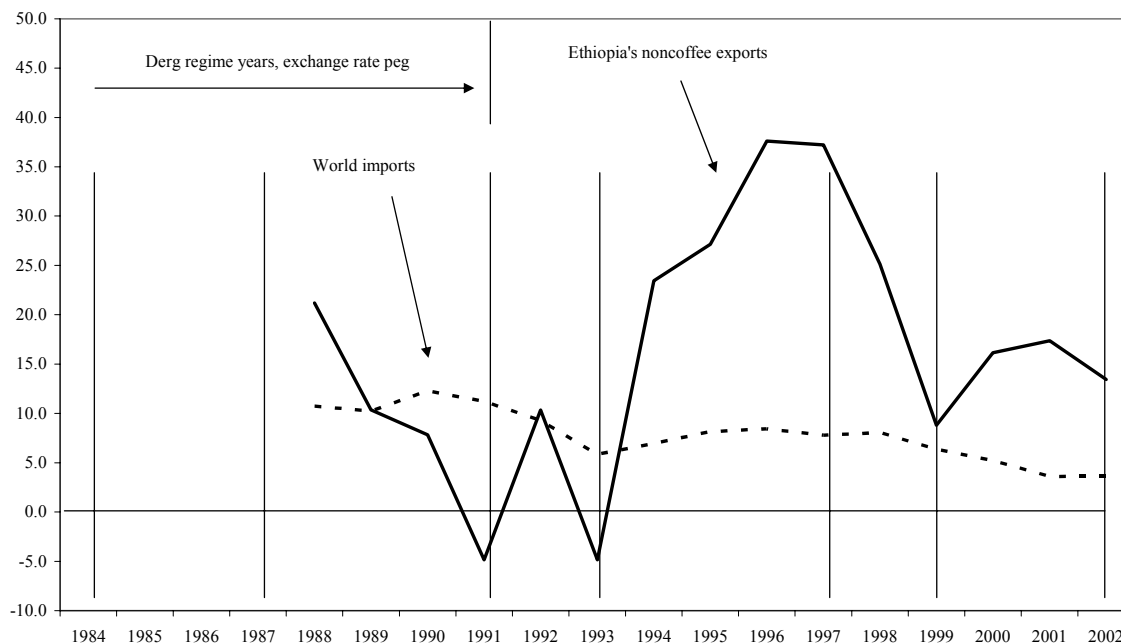
Sources: EDSS; Ethiopian authorities; and staff estimates.

Figure III.2. The Share of Ethiopia's Noncoffee Merchandise Exports



Sources: EDSS; Ethiopian authorities; and staff estimates.

**Figure III.3. Growth Rate of Ethiopia's Noncoffee Exports and World Imports
(Five-year moving average)
(Drought years are shown by the vertical lines)**



Sources: EDSS; Ethiopian authorities; and staff estimates.

C. Empirical Analysis

31. The staff undertook econometric analysis of the historical relationship in Ethiopia between foreign aid (grants and loans) and the real exchange rate and between aid and noncoffee exports (Annex 1). Contrary to the findings of studies that used large country panel data that also included Ethiopia in the sample,⁹ the staff's estimation results suggest

⁹ Most of the existing empirical studies used panel data covering a large number of aid-receiving developing countries to draw generalized conclusions on the relationship between aid inflows and the real exchange rate and export performance. Among the recent empirical studies by Fund staff using country panel data that included Ethiopia in the sample are Arellano *et al* (2003) and Prati *et al* (2003). Prati *et al* (2003) estimate that a one percentage point increase of aid in percent of GDP leads to a 0.31 percent increase in the rate of change of the real exchange rate while Arellano *et al* (2003) estimate that a one percentage point increase of aid in percent of Gross National Income (GNI) leads to 1.11 percentage point decline in the share of nonmining exports or 0.86 percentage points decline in the share of manufacturing exports. The estimation results thus indicate that: (1) foreign aid leads to real exchange rate appreciation; (2) countries with higher aid tend to have lower share of nonmining exports; and (3) countries with rising aid tend to have a declining share of nonmining exports.

that foreign aid has had a positive impact both on Ethiopia's noncoffee exports and their share in total exports. One possible interpretation of this result is that—given the low level of development in Ethiopia (as well as a lower level of aid in per capita terms compared to other aid-receiving countries)—the positive impact of foreign aid on infrastructure and capital investment (and the associated reductions in transaction costs) outweigh, over the long run, any adverse impact that aid inflows might have on the competitiveness of the traded goods sector by pushing out the production possibilities frontier. Regarding the relationship between aid and the real exchange rate behavior, the estimation results are inconclusive. This could be due to severe structural rigidities and the lack of functioning market mechanisms in the Derg regime years and subsequent structural transformation shifts associated with the reform process.

D. Conclusions and Policy Implications

32. The results of the empirical analysis indicate that the historical relationships would not serve as a reliable guide to the potential impact of higher aid flows on Ethiopia's tradable goods sector, not least because foreign assistance needed to achieve the MDGs would be significantly higher than the levels observed in the past, which could, by itself, change the structural relationships. Furthermore, it is clear that some upward adjustment of compensation in the health and education sectors would be needed to help achieve the targets. The emergence of wage and price pressures necessitate the formulation of structural reform measures over the medium term to alleviate such pressures, and hence, prevent a deterioration of the traded goods sector's competitiveness via the real appreciation of the exchange rate. There are two main routes through which the demand-driven pressures on the exchange rate can be moderated: channeling part of the increased domestic demand abroad via further opening up of the economy to foreign trade; and meeting part of the increased demand by boosting productivity and cost efficiency, and thereby increasing the supply of domestically produced goods and services. The speedy implementation of measures to further liberalize the foreign trade regime, eliminate any remaining exchange restrictions, streamline customs procedures, resolve difficulties in the areas of credit, land availability, competition policies, and infrastructure would go a long way towards achieving these objectives. The recently completed Diagnostic Trade Integration Study (DTIS) and the recommendations of the Technical Committee on necessary structural reforms should provide appropriate guidance to the authorities. While some appreciation of the real exchange rate could be unavoidable when rising incomes and productivity lead to an equilibrium real appreciation, the steadfast implementation of the structural reform agenda should prevent any unwarranted appreciation of the exchange rate.

Annex III.1

Impact on exports

33. A time-series analysis using an error-correction model was conducted to estimate the relationship between aid inflows and noncoffee exports, following, in principle, the model specification in Arellano and others (2003). In the estimation, noncoffee exports in percent of GDP was regressed over the period 1972-2001 with aid inflows in percent of GDP, international trade tax in percent of total tax revenue, investment in percent of GDP, and terms of trade. The long- and short-run relationships respectively are:

$$NCof_t = 0.2Aid_t + 0.17Tax_t + 0.54Inv_t + 0.0003TOT_t - 11.48$$

$$\Delta NCof_t = -0.43\Delta NCof_{t-1} + 0.13\Delta Aid_{t-1} - 0.006\Delta Tax_{t-1} - 0.03\Delta Inv_{t-1} - 0.003\Delta TOT_{t-1}$$

where $NCof$ is noncoffee exports in percent of GDP, Aid is aid inflows in percent of GDP, Tax is international trade tax in percent of total tax revenue, Inv is investment in percent of GDP, and TOT is terms of trade.

34. The estimation results suggest that a one percentage point increase in aid relative to GDP would lead to 0.2 percent increase in noncoffee exports in percent of GDP. All the variables are integrated in the order of one (I(1)) and are significant at 5 percent level, except the terms of trade, and have the right sign, except tax.

35. An estimation based on ordinary least squares using stationary series (at first difference) indicates that only investment is significant at 10 percent level:

$$\Delta NCof_t = -1.07 + 0.09\Delta Aid_t + 0.09\Delta Tax_t + 0.1\Delta Inv_t - 0.001\Delta TOT_t + 0.2LGDP_t$$

where, in addition to the specification in the error correction model, $LGDP$ is log of GDP per capita, which was excluded from the error correction model due to overidentification of the cointegrating equation.

36. A modified version of the analysis based on a shorter time series (1984-2001), for which better quality data on the breakdown of coffee and noncoffee exports are available, indicates that a one percentage point increase in aid relative to GDP would result in a 2 percent increase in the share of noncoffee exports in total exports. This stronger positive correlation result is most likely due to the fact that the post-1991 reform period accounts in this case for the larger share of the data sample.

Impact on the real exchange rate

37. A time-series analysis using an error-correction model was conducted for Ethiopia following the model specification in MacDonald and Ricci (2003). In the estimation, the

logarithm of real effective exchange rate was regressed over the period including the Derg regime (1982Q2-2002Q4) as well as over the reform period only (1992Q4-2002Q4), with the real GDP per capita relative to that of trading partners, terms of trade, exports and imports of goods in percent of GDP, fiscal balance (domestically financed) in percent of GDP, and aid inflows in percent of GDP. The cointegrating equation is:

$$\ln e_t = \alpha_0 + \alpha_1 GDPD_t + \alpha_2 TOT_t + \alpha_3 Trade_t + \alpha_4 Fiscal_t + \alpha_5 ODA_t + \alpha_6 t$$

where e_t is real effective exchange rate, $GDPD_t$ is the real GDP per capita relative to that of trading partners (in index with 1995=100), TOT_t is weighted terms of trade, $Trade_t$ is exports and imports of goods in percent of GDP, $Fiscal_t$ is fiscal balance (domestically financed) in percent of GDP, ODA_t is aid inflows in percent of GDP, and t is time trend. Five lags were chosen using a maximum likelihood ratio test.

38. The estimation results suggest that a one percentage point increase in aid relative to GDP would lead to 0.03 percent depreciation of the real exchange rate during the reform period, while, for the period including the Derg regime, a one percentage point increase in aid is associated with 1.5 percent appreciation. All the variables in the cointegrating equation are integrated in the order of one (I(1)) and are significant at 5 percent level.

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IV. STRUCTURAL REFORM PRIORITIES FOR IMPROVING FISCAL MANAGEMENT IN ETHIOPIA¹⁰

A. Introduction

39. **This section surveys current and emerging priorities for the structural reform of fiscal management in Ethiopia.**¹¹ In advance of possibly stepped-up donor aid to achieve the Millennium Development Goals (MDGs), a critical objective will be to develop the capacity of fiscal institutions in order to improve poverty-reduction outcomes. In this manner, advancing structural reforms in the areas of fiscal decentralization, public expenditure management (PEM), and revenue administration will represent key aspects of the broader reform agenda. Further, pursuing these structural reforms will support decentralized democratic governance, strengthen budgeting capacity, and build institutions that foster private sector development.

40. **The paper assesses the still unfolding process of fiscal decentralization, which has represented the predominant reform priority of recent years.** Contrary to initial concerns about diminished macro-fiscal control, decentralization has proceeded relatively smoothly, given the rapid timetable for its implementation. In addition, decentralization has successfully enhanced opportunities for democratic governance. Although decentralization is unlikely to deliver large efficiency gains in the short term, the process holds the potential to yield significant benefits over the longer term by enabling public spending to respond flexibly to regional priorities. A restructured system of intergovernmental block grants could facilitate this process, while ensuring that devolved mandates for social spending are not crowded out by the high cost of building local fiscal institutions.

41. **Looking ahead, a broad range of structural reforms are also needed to enhance fiscal management more generally.** For example, strengthening public expenditure management in the areas of budget formulation, execution, and reporting are critically needed to improve the effectiveness of poverty-reducing spending, particularly ahead of potentially higher MDG-related inflows. Private sector development can be supported by continuing reforms to the tax and customs administrations to enhance revenue-raising efficiency within an accommodating tax environment.

42. **This section is organized in three parts.** Part B outlines intergovernmental fiscal arrangements in Ethiopia, and assesses the recent decentralization in the context of the efficiency implications, the transfer formula and the impact for macro-fiscal stabilization. Part C surveys the key aspects of the reform process for public expenditure management, particularly budget formulation, auditing, and reporting. Finally, Part D explores reform

¹⁰ Prepared by Todd Mattina (FAD).

¹¹ This paper is based on discussions with officials, and draws from a number of IMF and World Bank documents, several of which are preliminary.

priorities for the tax and customs administration that could enhance revenue-raising efficiency, encourage trade, and strengthen the business environment.

B. Fiscal Decentralization

Background

43. **The general government comprises several levels of administration.** For instance, the constitution provides for a central government, nine regional governments¹², zonal-level administrations, two special city administrations for the largest urban areas (Addis Ababa and Dire Dawa), 550 woredas with elected councils, and six special woredas with the status of zones. There are also numerous municipalities with additional expenditure responsibilities. Table IV.1 summarizes the division of expenditure assignments following decentralization to the woredas.

44. **The first major wave of decentralization in the mid-1990s transferred expenditure responsibilities from the federal to regional governments.** Decentralization was motivated by the goals of improving resource allocation while enhancing decentralized democratic governance, given the ethnic and socioeconomic diversity of the country.¹³ Continued administrative rigidity and fiscal hierarchy motivated a second wave of fiscal decentralization that began in 2001 with the four largest regions –Amhara, Oromiya, Southern Nations Nationalities and Peoples Region (SNNPR), and Tigray—proceeding as pilots in transferring expenditure responsibilities to the woredas.

45. **Decentralization widened the fiscal asymmetry between spending mandates and revenue-raising potential.** For instance, the federal government continues to collect over 80 percent of general government tax revenue, while the share of regional government fiscal operations has increased from about a quarter to a third of consolidated expenditure since 1999/2000 (Table IV.2). Regional governments also deliver an increasing proportion of consolidated pro-poor spending. For instance, the regions provide over 80 percent of total recurrent spending in health and education. Further, the regions provide over a third of consolidated capital spending in the social development sectors. In line with the decentralization of expenditure commitments, the total regional government budget deficit has increased by about 2 percent of GDP since 1999/2000, largely as a result of weak own-source revenue growth and higher expenditure commitments (Table IV.3).

46. **An unconditional block grant represents the principal mechanism to balance resources across regions and governments.** Transfers represent more than a third of federal

¹² The regions reflect diverse ethnic and socioeconomic areas, including primarily pastoral and nomadic regions that vary in population size by a factor of 50.

¹³ World Bank. “Issues in State Transformation: Decentralization, Delivery and Democracy”. Draft Institutional Governance (IGR) Concept Note.

spending, and finances about three-quarters of subnational government expenditure (Figure IV.1). Budgeted transfers have risen sharply since the conflict between Ethiopia and Eritrea abated in 1999, although outturns have fallen short (Figure IV.2A). The source of this uneven budget implementation has been lower-than-expected receipts of external aid, while domestic sources have met or even surpassed budget targets (Figure IV.2B). Despite a traditional policy goal of promoting balanced regional progress through block grants, in practice, there are large regional discrepancies in poverty-reducing expenditure per capita¹⁴, suggesting that the transfer system could be improved by delivering greater horizontal equity across regions.

Efficiency gains from Decentralization

47. **Fiscal decentralization holds the potential to unlock significant efficiency gains, owing to the better matching of public spending with local priorities.** For instance, regions have achieved varying degrees of economic development that could result in a differing pattern of local demand for public services. Further, decentralization can enhance democratic governance by improving accountability and accessibility to decision making. However, two factors have emerged in the Ethiopian context that could offset these benefits. First, the costs of building new fiscal institutions at the local level to manage devolved spending mandates have been larger than anticipated. Second, local budgets have limited expenditure and staffing flexibility to exploit potential efficiency gains.¹⁵

48. **With respect to the cost of the decentralization, the largest region of Oromiya projected the need for a large increase in both recurrent and one-off spending to cover the higher wage bill and the fixed costs of providing new offices and equipment.** For instance, regional authorities estimated the need for about 88,000 staff, excluding the health and education sectors. Although the higher federal transfer amounts to Birr 1 billion in 2002/03, the cost of a higher number of administrative staff amounts to Birr 1.1 billion per annum, based on federal staffing guidelines.¹⁶ As a result, there is a risk of creating unfunded mandates, unless federal transfers increase sufficiently to meet the larger-than-budgeted administrative costs associated with decentralization. There is also a risk that the federal and regional governments will retain a disproportionate share of public resources, so that woredas lack sufficient funds to meet higher spending obligations.

49. **Wage costs dominate local government budgets, representing as much as 85-90 percent of total expenditure for some woredas.**¹⁷ Further, the woredas typically lack autonomy in employment and wage setting. As a result, the woredas in practice have little

¹⁴ World Bank, *Public Expenditure Review*, 2002/03, preliminary draft.

¹⁵ World Bank, *Public Expenditure Review*, 2002/03, preliminary draft.

¹⁶ World Bank, *Public Expenditure Review*, 2002/03, preliminary draft.

¹⁷ World Bank, *Public Expenditure Review*, 2002/03, preliminary draft.

flexibility in adjusting overall spending to better meet local priorities or improve service delivery, at least in the short term. Further, to address weak budgeting capacity at some woredas, higher levels of government provided guidelines for the composition of expenditure, such as the share of capital and recurrent spending. If these guidelines are rigidly followed in the future as a substitute for developing local budgeting capacity, then the flexibility of local budgets to realize opportunities for improved efficiency could be further restricted. In addition, woredas will need time to develop a capacity for identifying differences in local needs compared to the general guidelines, improve the operational use of available resources, and improve local revenue collection.

50. **These factors suggest a limited scope for achieving significant efficiency gains in the short run, until local government capacity and budget flexibility improve.** As a result, decentralization is unlikely to secure significant operational savings that could facilitate improved services delivery. The critical factor that will enable subnational governments to better meet local priorities will be sufficient transfers provided through the block grant system. However, the tight federal government budget constraint suggests that local authorities will need to rely on enhancing budget flexibility to achieve the potential efficiency gains available from fiscal decentralization.

The block grant formula

51. **Fiscal arrangements in Ethiopia entail a significant asymmetry between the capacity to raise own-source revenue and expenditure responsibilities.** Block grants have operated as the principal tool to address this vertical imbalance between governments. The current system also allows for greater horizontal balance so that lower-income regions receive a relatively higher share of total transfers. The current mechanism provides the federal government significant discretion in establishing the overall transfer envelope, which is determined using a macro-fiscal model, and after assuring that the federal government has retained sufficient resources to meet its own nondiscretionary spending needs. In practice, the block grant determines the final budget constraint of regional governments since they cannot borrow. Regional governments replicated the federal grant formula for distributing transfers to woredas, but in a simplified manner, given limited local sector data and evolving administrative capacity.

52. **The decentralization from regions to woredas was implemented rapidly and with limited advance planning.** However, a pragmatic and flexible approach greatly facilitated the transition, avoiding mismatches between expenditure mandates and available resources. In some cases, the block grant formula provided insufficient resources to local governments, relative to existing expenditure commitments. Regional governments, however, accommodated these shortfalls through contingency funds, hardship allowances for redeployed staff and pooled administrative resources to bolster capacity.¹⁸ This pragmatic

¹⁸ World Bank, *Public Expenditure Review*, 2002/03, preliminary draft.

approach avoided pervasive unfunded mandates or spending arrears during the transition. However, these solutions were transitional and nontransparent in nature, highlighting the need for a review of the block grant system to support the decentralization program looking ahead.

53. **The federal transfer mechanism to regions has followed a largely unchanged formula since 1995.** In particular, the formula involves variables that only proxy for actual expenditure needs. These variables include regional population in line with the 1994 census, percentage of residents living under the poverty line as determined by the Central Statistical Authority, a development index that measures public services provision, such as student-teacher ratios or health clinics per capita, and a revenue effort index calculated as the ratio of own-source revenue to recurrent spending. The weights attached to each variable have evolved somewhat over time, but in 2003/04, they were set at about 55 percent for population, 20 percent for the development index, 10 percent for the poverty index, and 15 percent for revenue effort. The formula for woredas varies somewhat by region, but typically incorporates similar variables, including population, an economic development index, and revenue mobilization.

54. **There are a number of problems with the existing block grant formula.** Perhaps most significantly, the factors driving the formula are not explicitly linked to preexisting expenditure commitments. The large population weight of about 60 percent determines most of the transfer, although population alone does not correspond directly to expenditure commitments, given the wide range in regional economic development. As a result, regions or woredas with a higher-than-average number of schools and health clinics tend to receive insufficient grants. Another problem relates to the development index, which equally weights each category of sectoral social spending, leading to a bias in the indicator, since the underlying components account for quite different shares of overall spending. For example, health spending typically absorbs at least half of the recurrent budget, but is weighted equally in the grant formula with smaller components of the budget. Finally, the proxy for revenue effort is calculated as the ratio of own-source revenue to recurrent spending. However, recurrent spending will be largely determined by revenue collections, confounding the information about local tax effort provided by the index.

55. **A positive direction for the reform of the block grant formula would be to tighten its link to existing expenditure commitments so that the transfer closes the fiscal gap arising from the asymmetry in revenue and expenditure mandates.** The international experience provides several models that could provide lessons for a similar mechanism in Ethiopia. For example, approaches based on the principle of “equalization” entail providing subnational governments with sufficient transfers so that comparable levels of public service can be offered across regions for a similar burden of taxation. In line with this approach, the formula should subsidize regions with a smaller tax base in order to finance comparable public services as higher-income regions. In the case of Ethiopia, the wide regional dispersion in poverty-reducing spending per capita suggests that a transfer system based on the principle of equalization could be a fruitful approach to achieve greater regional balance.

56. **Finally, a challenging aspect for properly designing the grant formula is mitigating perverse performance incentives.** For instance, grants can inadvertently reward failure or promote complacency in aggressively pursuing administrative reforms. For instance, if the effective tax base is actually greater than suggested by collections (perhaps owing to weak effort to expand capacity), then compensating federal grants would discourage needed reforms. In addition, the practice of offsetting federal block grants to regions that receive donor aid provides an incentive to misreport disbursements, or even reject external assistance to the detriment of overall national objectives. Reflecting this concern, the formula was modified somewhat during 2000/01 to incorporate partial offsets. Specifically, the offset for external financing was reduced to 70 percent, and just 30 percent for external grants.

Macro-fiscal stabilization following decentralization

57. **A principal risk stemming from decentralization is loosened macro-fiscal control.** For instance, there could be diminished prudence in fiscal policy implementation as numerous subnational governments become responsible for a large share of consolidated spending. Further, decentralization can entail efficiency losses, owing to weak intergovernmental coordination, especially if preferences for public services are actually quite similar across regions (Tanzi, 1996). A poorly designed or implemented fiscal decentralization could also encourage unsustainable local government borrowing, or the accumulation of arrears. Despite these risks, decentralization has proceeded well in Ethiopia, particularly given the rapid pace of the functional reassignments. The wide diversity in regional income patterns suggests large potential efficiency gains from devolving spending to local governments. Further, subnational governments have not borrowed or accumulated arrears, forestalling a possibly unsustainable rise in the domestic public debt.

58. **However, an area that continues to jeopardize macro-fiscal stabilization is the weak overall capacity of the woredas.** It remains unclear how effectively these entities can absorb substantially larger budgets over the medium term. During the decentralization transition, policy slippages have been limited by inflexible expenditure composition and budgeting guidelines for the woredas. However, weak public expenditure management (PEM) systems also limit the scope for woredas to manage capital projects, especially projects involving complex donor requirements. As MDG-related donor inflows accelerate, improving this capacity will become an increasingly critical priority. Similarly, capacity constraints in PEM could also affect the efficacy of the rapidly scaled-up Food Security Program, a domestically financed Birr 2 billion (2.6 percent of GDP) program that is mostly transferred to subnational governments with an earmarked share for capital projects to improve agricultural productivity. Although the guidelines for budget formulation are intended as a transitional mechanism to compensate for weak local capacity, realizing the efficiency gains accruing from decentralization will require more autonomous budgeting looking ahead. How the woredas manage increased fiscal autonomy will have implications for macro-fiscal control.

59. **Finally, greater local government autonomy through accelerated decentralization does not readily square with the need to implement national economic objectives as identified in the PRSP process.** This fundamental policy tension can be pragmatically balanced by requiring woredas to satisfy minimum performance standards. These standards can be established through a mix of budget guidelines, such as spending floors in key poverty-reducing sectors and minimum sectoral performance results, such as student-teacher ratios or health clinics per capita. These performance benchmarks could be augmented with penalties to ensure compliance with the national or regional objective.

C. Public Expenditure Management

Budget formulation

60. **Improved budget planning represents a critical reform priority to improve fiscal management and achieve stronger poverty-reduction outcomes.** For instance, there are often significant deviations between actual fiscal outturns and the original budget formulation, especially at the regional level. This mixed track record has weakened the reliability of the budget process, and has diminished its effective role as the principal mechanism to channel scarce public resources to high-priority areas. This problem has also been compounded by the fragmented budget structure, characterized by earmarked revenue to finance numerous extrabudgetary funds. The planning process could be improved by adopting several key reforms in the short term, including (i) the urgent need to mandate more rapid reporting by subnational governments, (ii) coordinating with donors to improve estimates of the destination and sectoral composition of grant-financed project spending, and (iii) adapting current institutional structures to improve the budget system, such as linking the budget to a medium-term expenditure framework, and rolling out an integrated financial management information system to the regions.

61. **Long delays in reporting in-year fiscal outcomes represents a critical weakness in budget preparation, limiting the opportunities for policy makers to learn from recent experience.** Following decentralization, regions and woredas have scrambled to build reporting capacity as each woreda individually prepares and reconciles its financial accounts with varying lags. Inadequate tracking of project spending financed by donor grants represents another problem that has impeded budget preparation and reporting. As a result, the sectoral breakdown of poverty-reducing spending cannot be effectively monitored by budget planners, further hindering the efficient allocation of domestic resources.¹⁹ Further, the World Bank estimates that the budget only captures about two-thirds of actual grants²⁰, resulting from valuation problems of in-kind food relief, the disincentive to report grants to

¹⁹ External aid (defined as grant and loan disbursements) represents about 35 percent of consolidated government expenditure on average.

²⁰ World Bank, *Public Expenditure Review: Ethiopia, 2002/03*, preliminary draft.

regions, and donor reporting in an unusable format. Greater coordination with donors to strengthen the reporting of their activities using a conformable system of budget classification would greatly facilitate planning and budget reliability. As a result, it will be critical to monitor the effectiveness of the forthcoming “donor aid platform”, designed to address these issues.

62. **The institutional design of the Ministry of Finance and Economic Development (MoFED) could also be strengthened to enhance budget formulation.** For instance, the amount of block grant transfers to regions should be explicitly linked to a medium-term expenditure framework incorporating the inputs of line departments and harmonized with regional governments to ensure consistency. Consistent with this broader aim, MoFED has developed a detailed three-year rolling Public Investment Plan with information available by individual project. Regions are also building capacity in this area.

63. **The budget formulation of regions and woredas could also be strengthened by adhering to a fixed budget preparation calendar.** Higher levels of government have been slow at times to inform lower-level governments about the final distribution of transfers. In one instance, a costly second round of regional budget planning was required because the federal government delayed a final decision regarding the distribution of block grants.²¹ Moving to a fixed budget calendar would facilitate an orderly flow of information so that budget planners at all government levels can incorporate changes early in the preparation process. In addition, ensuring a fully consistent chart of accounts with the central government is important to enhance planning and reporting.

64. **Budget formulation would be greatly facilitated by rolling out an automated and integrated financial management information system based on double-entry cash accounting to all regions.** A significant factor explaining the slow reporting of fiscal results has been the manually intensive procedures currently employed in many regions. As fully integrated financial management systems are rolled out over the medium term, interim homegrown systems have proved to be effective for tracking disbursements in a more user-friendly format for less-skilled staff.

65. **Budget formulation had been hindered prior to 2003/04 by incomplete fiscal coverage, particularly the exclusion of numerous extrabudgetary funds that account for about 10 percent of consolidated government expenditure.** Although the funds are now covered in the fiscal accounts, the practice of earmarking revenue to finance their activities has impaired the flexibility of the budget to meet shifting spending priorities over time. For instance, surplus proceeds held by the Road Fund cannot be readily reallocated for other pressing social priorities.

²¹ World Bank, *Public Expenditure Review*, 2003/04, preliminary draft.

Budget execution

66. **Budget execution has typically been fairly disciplined in Ethiopia.** Corruption has been much less prevalent than in other countries in the region, and the government has succeeded in avoiding expenditure arrears. However, budget execution could be improved by (i) building capacity for the audit and control functions, (ii) clearing the backlog of accounts for audit, and (iii) strengthening cash flow management, the commitments control system, and the procurement system for public goods and services.

67. **The first step to improve expenditure control is to delineate the functions of internal and external auditors and the jurisdiction of the central and regional Auditor General offices.** Each region and the central government have an Auditor General office that reports to its respective parliament. The federal Auditor General can also examine if block grants have been effectively spent by subnational governments. The auditor generals are responsible for reporting their findings within six months from the time the accounts have been submitted. However, prepared and reconciled accounts can be delayed by over two years from the close of a fiscal year.

68. **Achieving more effective internal controls and auditing requires strengthening the procedures at both the line departments of the central government, and the systems of most subnational governments.** Realigning salary levels might also be required to attract skilled staff, especially auditors. Further, the central government can step up its interim staffing assistance to regions until local capacity improves. Overall staffing is a critical issue as about half of federal auditors have already been redeployed to the regions, while the anti-corruption agency has also absorbed a number of auditors. An urgent short-term measure to address shortcomings in internal control and audit include the more rapid preparation and dissemination of manuals to assist staff.

69. **In addition to the control and audit functions, improved budget systems are needed to improve fiscal management capacity.** For instance, the system of expenditure commitments control should be strengthened so that the laudable track record of avoiding expenditure arrears can be maintained. Improving cash management is also a priority to facilitate a more orderly expenditure profile within the fiscal year. As the central government rolls out an automated accounting system based on double-entry cash accounting, the system will be better able to track and control disbursements consistent with a common chart of accounts across government levels. The central government should also adopt an internationally recognized code for procurement, while the Auditor General office should verify that large procurement contracts achieve “value for money” through a transparent process.

D. Revenue Administration

Tax administration

70. **Significant progress has already been achieved since 2001, including the establishment of a Large Taxpayers Office (LTO), a new Ministry of Revenue, and the**

introduction of a value-added tax (VAT) along with a modernized VAT-specific administration. A significantly lower nonfiling rate over the past year reflects stepped-up efforts to improve enforcement. Ethiopia's relatively high tax ratio for a predominantly agricultural economy implies that future reforms will not be motivated by raising substantially higher revenue. The objective should therefore be to improve revenue-raising efficiency, which will promote private sector development through a more supportive tax environment. In this manner, the tax administration could advance structural reforms by integrating the VAT into the regular apparatus of the tax administration, incorporating greater automation to support the system of self-assessment, and strengthening human resources.

71. **Greater automation will be a crucial aspect of improving the administrative efficiency of the current system.** A first step should be to extend the use of automated systems employed by the VAT administration throughout the broader tax administration. In this manner, the assignment of taxpayer identification numbers (TINs) to all registered taxpayers should proceed as a priority. In addition, collecting the VAT should be integrated into the regular tax administration, especially the LTO. Other branches of the tax administration should also be unified into a single integrated institution that makes extensive use of automated systems to improve collections, manage tax arrears, and identify nonregistered taxpayers. Greater automation will also support the system of self-assessment by redeploying existing staff that manually double-check returns and supporting documentation to higher value-added activities, such as collection and enforcement. Over the medium term, developing a high-caliber professional staff will facilitate these structural reforms.

Customs administration

72. **Further structural reforms of the customs administration can support broader macro objectives, such as facilitating trade growth in a manner compliant with the World Trade Organization and World Customs Organization.** Recent structural reforms have already delivered positive results in terms of securing higher revenue. In addition, the time required for goods clearing has declined from about 48 days to under 48 hours. Steps have also been taken to improve human resources through the aggressive recruitment of university graduates and enhanced training of staff. Further, risk assessment for auditing goods in transit has been introduced, offering the potential to curtail smuggling.

73. **The critical challenge, looking ahead, will be to foster a stronger system of self-assessment in customs, supported by improved risk assessment and auditing methods.** Selective auditing of goods in transit is a clear priority; however, the customs administration should also bolster its tools to assess taxpayers following the release of goods. Greater automation of simplified declaration forms that can handle both the security deposit and the transit of goods will facilitate this process. The expanded use of the various features of UNCTAD's Automated System of Customs Data (ASYCUDA) to collect and analyze trade data, input declarations, and handle manifests is also a necessary step to improve customs control and underpin the system of self-assessment. Over the medium term, the customs

administration can further contribute to macro-fiscal objectives by instituting an effective anti-smuggling system that applies appropriate selection criteria to identify high-risk traders. In light of the porous border, implementing an anti-smuggling program will represent a key measure to improve border control and limit opportunities for an expanded informal economy.

E. Conclusion

74. **This section surveyed the main reform priorities associated with the evolving process of fiscal decentralization.** Devolved spending mandates should provide long-term efficiency benefits by better matching public spending to disparate local needs, and achieve savings by improving expenditure allocation. However, these potential gains have been offset by the high cost of expanding local institutions to manage decentralized expenditure responsibilities, and the limited budgeting and staffing flexibility of the woredas. As a result, the block grant system should be carefully evaluated to avoid unfunded mandates, especially given the large share of consolidated pro-poor spending undertaken by subnational governments.

75. **In addition, advancing the structural reform of PEM represents a critical aspect of the larger initiative to enhance fiscal management.** In that regard, improving budget formulation and execution represent critical components of the PEM agenda, looking ahead. Decentralization exacerbated several existing reporting weaknesses and also gave rise to new capacity-building priorities. Key areas for reform include enhancing budget formulation through improved reporting by woredas and regions, greater donor coordination to track project spending, and rolling out financial management information systems.

76. **Reforms to the tax and customs administrations should focus on improving revenue-raising efficiency to promote private sector development through a supportive tax environment.** Nurturing a strong system of taxpayer self-assessment will require greater automation, and reallocating staff resources to higher value-added activities, such as collection and enforcement. Strengthened risk assessment and taxpayer services will be critical to underpin an improving tax administration over the medium term.

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Table IV. 1. Ethiopia: Expenditure Responsibilities Following Woredas Decentralization

Level of Government	Expenditure Assignments
Federal government	<ul style="list-style-type: none">• Defense• Foreign relations• Justice and internal security• Macro stabilization• International trade• Currency and banking• Immigration• National interest capital projects• Shared with regions: environment, airlines, and railways
Regional government	<ul style="list-style-type: none">• Secondary education• District and referral hospitals• Nursing schools• Water supply• Regional and zonal roads• Regional police• Maintenance of irrigation systems• Maintenance of smaller-scale water supply projects and energy programs• Agricultural planning• Shared with federal: justice, environment, police, and vocational and preparatory schools
Woredas	<ul style="list-style-type: none">• Primary education• Basic health care• Agricultural extension programs• Veterinary clinics• Land use administration• Water development, wells construction and maintenance• Local police• Local roads• Shared with regions: small-scale capital projects

Table IV.2. Ethiopia: Regional Fiscal Operations as a Share of Consolidated Government 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04 Estimate
	(In percent of GDP)					
Total revenue 2/	14.8	15.8	14.2	15.3	13.4	12.6
Tax revenue	19.5	19.3	18.7	18.3	19.0	18.0
Nontax revenue	14.2	17.2	15.9	20.6	18.6	17.7
Total expenditure	29.2	24.7	32.6	30.8	30.4	32.0
Current expenditure	28.8	22.1	33.7	37.0	35.2	28.6
<i>Of which</i>						
Social services	78.1	71.3	77.5	71.2	75.3	81.6
Education	85.2	83.3	83.8	80.9	81.2	...
Health	78.7	82.6	80.9	88.2	86.8	...
Capital expenditure	31.2	29.6	20.3	25.0	23.3	24.6
<i>Of which</i>						
Social development	36.0	43.2	53.1	43.3	36.3	35.8
Education	16.3	44.5	37.8	31.4	27.1	...
Health	24.7	19.8	67.1	57.9	51.3	...
Roads	43.7	21.9	26.1	40.3	38.8	...

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30. Data by disaggregated social sector represent preliminary estimates.

2/ Revenue from taxes, rents, and fees levied and collected by the regional governments.

Table IV.3. Ethiopia: Regional Fiscal Operations as a Share of GDP, 1998/99-2003/04 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04 Estimate
	(In percent of GDP)					
Total revenue 2/	3.2	3.3	3.4	3.8	3.7	3.3
Tax revenue	2.2	2.3	2.6	2.8	2.7	2.7
Nontax revenue	0.9	1.0	0.8	1.0	0.9	0.7
Total expenditure	9.3	8.0	9.5	10.5	10.9	10.0
Current expenditure	6.2	5.7	6.5	7.5	8.3	7.0
<i>Of which</i>						
Social services	3.1	2.8	3.2	3.8	4.2	3.8
Capital expenditure	3.1	2.3	3.0	2.9	2.6	3.0
<i>Of which</i>						
Social development	0.8	0.5	1.0	0.8	0.8	1.3
Overall balance 3/	-6.1	-4.7	-6.1	-6.7	-7.2	-6.7

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

2/ Revenue from taxes, rents, and fees levied and collected by the regional governments.

3/ Deficit (-) covered by direct transfer from federal government of joint tax receipts and foreign assistance.

Figure IV.1. Ethiopia: Block Grant as a Share of Federal and Regional Spending, 1998/99-2002/03

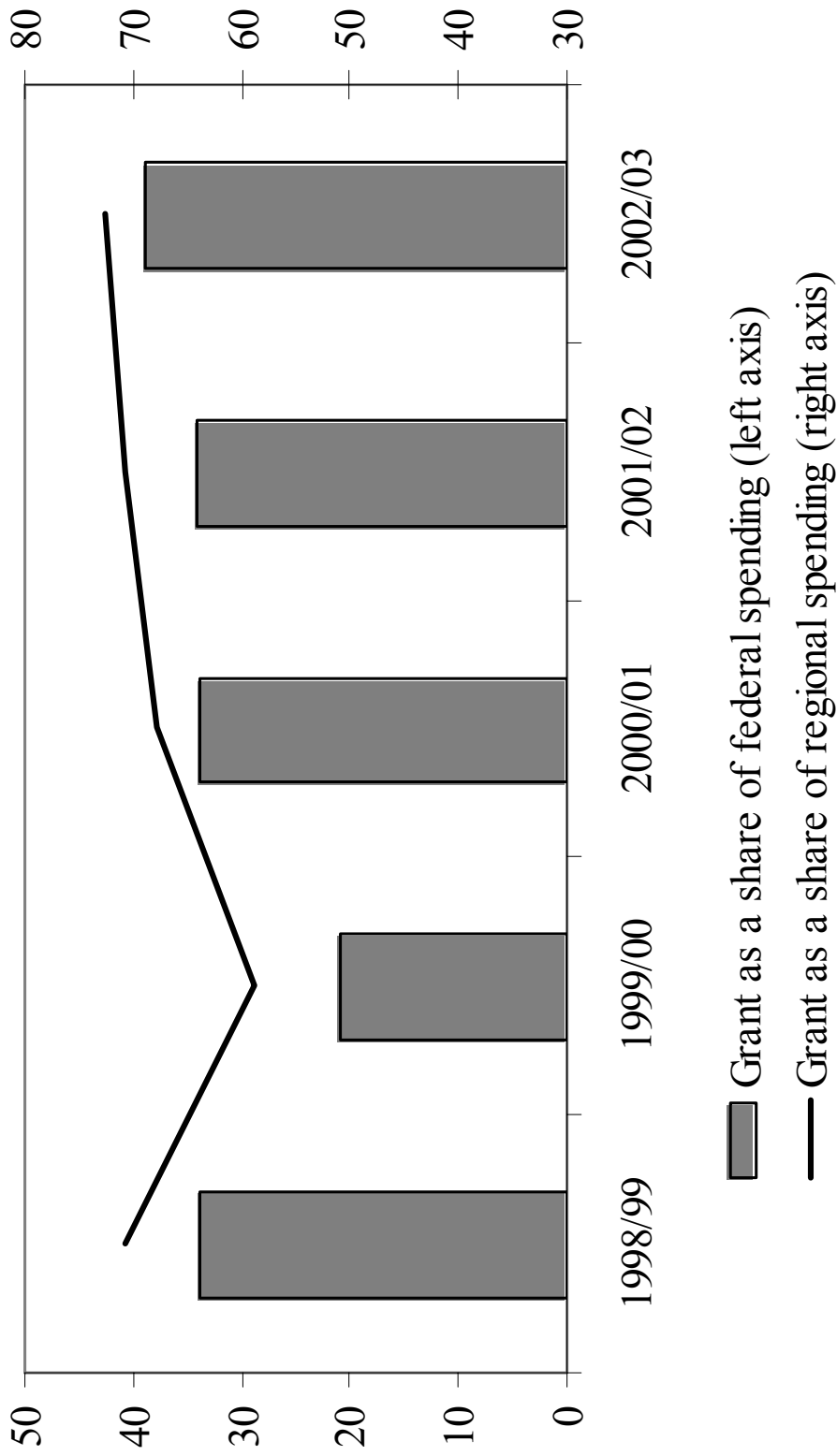
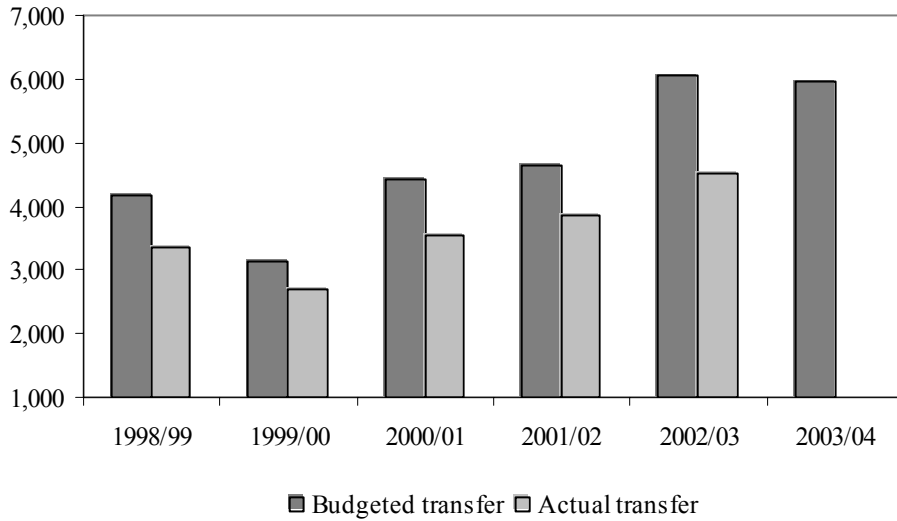
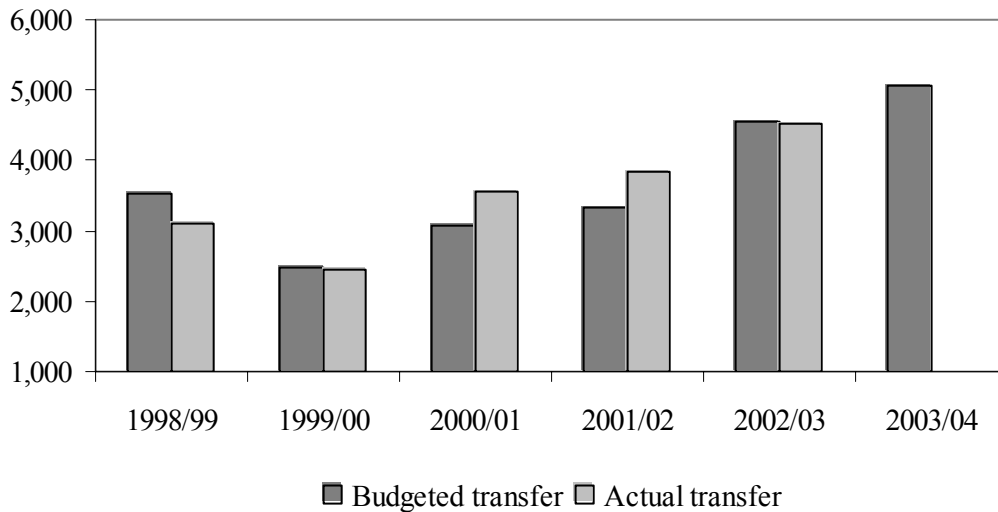


Figure IV. 2. Ethiopia: Block Grants from the Central to Regional Governments

Panel A: Block grants funded from domestic and external sources
(In millions of Ethiopian Birr)



Panel B: Block grants funded from domestic sources
(In millions of Ethiopian Birr)



V. FINANCIAL SECTOR DEVELOPMENT IN ETHIOPIA²²

77. This chapter provides an overview of financial sector reforms in Ethiopia and the agenda for the future. Section A provides an overview of the financial sector, section B describes ongoing financial sector reforms, section C compares the financial market structure and reform experience with other countries in the region, and section D considers the reform agenda for the future.

A. Overview of the Financial Sector

78. **The financial sector in Ethiopia is dominated by the banking system (Table V.1).** The financial sector comprises (i) the National Bank of Ethiopia (NBE), (ii) eight deposit-taking commercial banks, (iii) one development bank, (iv) 22 micro-finance institutions (MFIs), (v) an estimated 600 small savings and credit associations (SCAs), (vi) nine insurance companies, and (vii) two pension funds. The total assets of the financial sector at end-2002/03 (excluding SCAs) are estimated at Br 38.7 billion (68 percent of GDP), of which the banking system holds 94 percent.

Table V.1. Ethiopia: Financial Sector

	Number	Concentration 1/	Assets		Deposits	
			In millions of birr	In percent	In millions of birr	In percent
Banks	9	1	36,476	94.2	27,809	96.6
Public banks 2/	3	...	29,283	75.7	22,328	77.5
Of which: non-deposit-taking banks 2/	1	...	3,355	8.7	744	2.6
Private banks	6	...	7,193	18.6	5,481	19.0
Foreign-owned subsidiaries 3/	0	...	...	...	...	...
Branches of foreign banks 3/	0	...	...	...	...	...
Securities companies 3/	0	...	...	...	...	...
Insurance companies 3/	9	4	1,339	3.5	581	2.0
Other credit institutions 4/	22	3	792	2.0	303	1.1
Pension funds 5/	2	2	100	0.3	100	0.3
Total	52	3	38,708	100.0	28,793	100.0

Source: Authorities.

1/ Number of institutions with 75 percent of total assets in the subsector. For total, the share of the largest three banks (CBE, DBE, and Dashen Bank) represents 78 percent of the financial sector assets.

2/ The Development Bank of Ethiopia (DBE); the DBE has not taken deposits from the public, although it is allowed.

3/ Banking business by foreign banks are not allowed in Ethiopia. No securities companies exist.

4/ Including only microfinance institutions (MFIs). There are estimated 600 small savings and credit associations under supervision of regional governments, but no data are available.

5/ Exist only for public employees. Assets and deposits are proxied by the account outstanding of the social security authorities, as no balance sheet data are available.

Banks

79. **The banking sector is dominated by the state-owned Commercial Bank of Ethiopia (CBE).** Of the nine banks, (i) two are state-owned commercial banks – the CBE and the Construction and Business Bank (CBB); (ii) six are domestically owned private commercial banks established since 1994; and (iii) one is the state-owned Development Bank of Ethiopia (DBE). No

²² Prepared by Antoinette Dinga and Ayumu Yamauchi (AFR).

foreign-owned bank is allowed to operate in Ethiopia. The CBE is the most dominant bank, holding 76 percent of assets, 54 percent of loans, and 75 percent of deposits of the banking system at end-2002/03. The largest private bank, Dashen Bank, holds 4 percent of assets of the banking system. Although still highly limited, competition in the banking sector has been increasing as the dominance of the CBE, in particular with respect to its loan share, has gradually declined.²³

80. **The banking sector remains underdeveloped and highly liquid (Table V.2).** Broad money as a share of GDP is relatively high at 53 percent at end-2002/03. However, net claims on the government account for 59 percent of broad money, and currency for about 28 percent, indicating that financial deepening has largely been driven by an extension of credit to the government. Credit to nongovernment (i.e. private sector and public enterprises) has remained at about 20 percent of GDP since the early 1990s, consistent with the steady share of private investment and the industrial sector in GDP. Reflecting weak credit expansion to the private sector, excess reserves of the banks have remained high.

81. **Banks focus on short-term financing.** At end-June 2003, short-term trade financing accounted for 25 percent of loans outstanding and 53 percent of loans disbursed during 2002/03. Agriculture and industry account for 8 percent and 17 percent of loans outstanding, respectively, while housing and construction represents 11 percent. The private sector is the dominant borrower, accounting for 86 percent of loans outstanding. The DBE, which specializes in development finance, supplements long-term financing needs.

²³ The CBE's share in the banking system declined from 82 percent of assets at end-1996/97 to 76 percent at end-2002/03, from 72 percent of loans at end-1996/97 to 54 percent at end-2002/03, from 92 percent of deposits at end-1996/97 to 75 percent at end-2002/03.

Table V.2. Ethiopia: Monetary Survey
(In millions of birr, unless otherwise indicated)

	1992/93 July 7	1993/94 July 7	1994/95 Jun	1995/96 July 7	1996/97 July 7	1997/98 July 7	1998/99 July 7	1999/2000 July 7	2000/01 July 7	2001/02 July 7	2002/03 July 7
Net foreign assets	1,692	3,864	5,710	6,170	5,551	5,724	6,388	4,783	4,861	8,295	11,290
Net domestic assets	7,324	7,958	8,692	9,792	10,961	12,891	13,317	17,674	19,740	19,327	19,216
Net domestic credit	11,907	13,040	14,352	17,064	17,146	18,930	20,577	27,114	27,764	27,617	28,332
Net claims on the government	9,486	10,180	9,058	9,616	8,798	9,372	10,258	15,757	15,544	16,268	17,855
Claims on nongovernment	2,421	2,860	5,294	7,448	8,348	9,558	10,320	11,357	12,220	11,349	10,477
Claims on public enterprises	462	468	469	471	2,441	2,458	1,813	1,643	1,867	1,881	1,291
Claims on the private sector	1,959	2,392	4,825	6,978	5,908	7,100	8,507	9,714	10,353	9,468	9,186
Other items (net)	-4,583	-5,082	-5,660	-7,271	-6,186	-6,039	-7,260	-9,440	-8,024	-8,290	-9,117
Broad money	10,694	11,838	14,408	15,963	16,511	18,615	19,704	22,456	24,598	27,622	30,506
Money	7,916	8,612	9,922	10,154	9,981	10,965	11,658	13,265	13,778	15,457	16,815
Quasi-money	2,779	3,226	4,486	5,809	6,531	7,650	8,047	9,191	10,820	12,166	13,691
	(In percent of GDP)										
Memorandum items:											
Net foreign assets	6.3	13.6	16.9	16.3	13.4	12.8	13.1	9.0	9.0	16.0	19.8
Net domestic assets	27.5	28.1	25.7	25.8	26.4	28.7	27.3	33.2	36.4	37.2	33.7
Net domestic credit	44.6	46.0	42.4	45.0	41.4	42.2	42.2	51.0	51.2	53.2	49.6
Net claims on the government	35.6	35.9	26.7	25.3	21.2	20.9	21.0	29.6	28.7	31.3	31.3
Claims on nongovernment	9.1	10.1	15.6	19.6	20.1	21.3	21.1	21.4	22.5	21.9	18.4
Claims on public enterprises	1.7	1.7	1.4	1.2	5.9	5.5	3.7	3.1	3.4	3.6	2.3
Claims on the private sector	7.3	8.4	14.2	18.4	14.2	15.8	17.4	18.3	19.1	18.2	16.1
Broad money	40.1	41.8	42.5	42.1	39.8	41.5	40.4	42.2	45.4	53.2	53.4
	(In percent of broad money)										
Net foreign assets	15.8	32.6	39.6	38.7	33.6	30.8	32.4	21.3	19.8	30.0	37.0
Net domestic assets	68.5	67.2	60.3	61.3	66.4	69.3	67.6	78.7	80.3	70.0	63.0
Net domestic credit	111.3	110.2	99.6	106.9	103.8	101.7	104.4	120.7	112.9	100.0	92.9
Net claims on the government	88.7	86.0	62.9	60.2	53.3	50.3	52.1	70.2	63.2	58.9	58.5
Claims on nongovernment	22.6	24.2	36.7	46.7	50.6	51.3	52.4	50.6	49.7	41.1	34.3
Claims on public enterprises	4.3	4.0	3.3	2.9	14.8	13.2	9.2	7.3	7.6	6.8	4.2
Claims on the private sector	18.3	20.2	33.5	43.7	35.8	38.1	43.2	43.3	42.1	34.3	30.1
	(In percent, unless otherwise indicated)										
Excess reserves (in percent of deposits)	24.0	26.5	12.3	15.5	8.0	11.1	6.3	24.5	5.3	8.1	12.8
Money multiplier (broad money / reserve money)	1.58	1.59	1.91	1.96	2.32	2.51	2.71	1.98	2.90	2.77	2.41
Velocity (GDP / broad money)	2.49	2.39	2.35	2.38	2.51	2.41	2.48	2.37	2.20	1.88	1.87
Currency (in percent of broad money)	47.4	45.1	41.9	37.7	33.9	27.4	28.3	28.4	26.2	25.8	27.6
Private investment (in percent of GDP)	9.2	8.0	9.0	9.4	8.7	9.8	8.9	10.7	9.3	9.0	10.7
Industrial sector GDP (in percent of GDP)	10.4	11.0	11.2	10.3	10.5	10.9	11.1	10.7	10.5	10.9	11.9
Total assets of commercial banks (in percent of GDP)	39.9	47.5	51.4	54.4	57.1	65.2	61.4	63.9	69.8	83.1	91.6
Total loans of commercial banks (in percent of GDP)	9.2	10.4	16.3	20.6	22.0	23.1	23.3	23.8	24.9	25.6	23.0
Total deposits of commercial banks (in percent of GDP)	23.6	26.2	29.6	31.5	32.9	37.9	35.1	37.1	40.6	46.8	47.4
Net foreign assets of the banking system (in millions of U.S. dollars)	332	621	903	972	819	808	787	581	574	968	1313
Of which: NBE (in millions of U.S. dollars)	187	359	476	760	424	277	292	234	196	493	729

Source: Ethiopian authorities.

Table V.3. Ethiopia: Financial Soundness Indicators 1/
(In percent, unless otherwise indicated)

	1998 Jun	1999 Jun	2000 Jun	2001 Jun	2002 Jun	2003 Jun
Regulatory capital to risk-weighted assets	9.3	8.8	9.9	12.4	13.0	11.9
Of which: public banks	9.0	8.3	8.5	11.0	11.3	10.4
Regulatory Tier I capital to risk-weighted assets						
Of which: public banks						
Nonperforming loans to total gross loans	28.3	26.2	23.0	28.2	43.8	40.5
Of which: public banks	28.5	26.5	24.3	32.6	50.5	51.9
Nonperforming loans net of provisions to capital	132.7	117.4	80.8	110.3	167.8	121.7
Of which: public banks	142.3	122.1	87.6	137.7	211.4	155.0
Sectoral distribution of loans to total loans						
Agriculture	7.9	8.8	8.5	8.1	8.7	8.5
Industry	13.0	13.9	13.3	15.1	15.8	17.2
Domestic trade	16.2	12.7	13.5	11.5	10.4	10.9
International trade	21.2	21.5	18.8	18.2	16.9	14.4
Export	7.3	7.8	6.2	6.2	4.9	4.8
Import	13.8	13.6	12.7	12.1	12.0	9.6
Hotels and tourism	3.1	2.8	1.9	2.3	2.6	2.1
Transport and construction	6.7	4.4	5.7	5.5	4.5	3.4
Housing and construction	14.4	10.4	9.8	9.8	9.6	11.0
Mines, power, and water resources	0.2	0.2	0.1	0.1	0.1	0.2
Others	13.5	21.7	24.1	25.9	28.4	29.5
Personal	0.2	0.1	0.1	0.1	0.2	0.3
Interbank lending	3.6	3.6	4.0	3.1	2.9	2.6
Return on assets	1.1	0.3	1.9	0.4	-1.4	1.9
Of which: public banks	1.1	0.2	2.0	0.1	-1.9	2.1
Return on equity	23.9	6.6	25.4	4.5	-18.6	29.4
Of which: public banks	25.8	5.4	30.3	1.4	-31.5	40.4
Interest margin to gross income	43.1	40.2	44.8	41.0	24.7	34.3
Of which: public banks	43.4	42.1	45.8	41.2	19.5	32.5
Noninterest expenses to gross income	18.9	43.5	26.0	46.9	86.6	30.9
Of which: public banks	16.5	43.9	23.6	50.2	105.4	25.5
Liquid assets to total assets	29.3	29.0	36.8	32.8	39.3	53.5
Of which: public banks	29.0	28.4	37.2	33.3	40.4	59.0
Liquid assets to short-term liabilities	40.5	40.4	48.7	40.9	48.8	67.4
Of which: public banks	40.3	39.7	49.3	41.4	50.1	74.5
Net open position in foreign exchange to capital	0.0	0.0	0.0	0.0	0.0	1.8
Of which: public banks	0.0	0.0	0.0	0.0	0.0	1.0

Source: Ethiopian authorities.

1/ Excluding the DBE.

82. **The level of nonperforming loans (NPLs) in the banking system is high, due to a number of structural weaknesses** (Table V.3). A large portion of NPLs are held by public banks and have been nonperforming for a long period of time; some dating from the Derg regime (1974-1991). While the process of foreclosing on collateral by banks was streamlined in 1998,²⁴ write-offs of old NPLs have been hampered by a lack of authority within bank management and onerous requirements.²⁵ Loan classification and provisioning requirements have been strengthened in recent years, which, coupled with the effects of the border conflict and declining coffee prices, caused the NPLs to rise, in particular in 2002. The vulnerability of the economy to exogenous shocks, particularly droughts, also poses a high risk of deteriorating asset quality for the banking system.

83. **Excess liquidity in the banking system reflects both supply and demand factors.** From the supply side, factors include restrained lending activity by banks²⁶ under strengthened prudential regulations, steady deposit inflows owing to a lack of investment options other than bank deposits, and a constant inflow of remittances and donor assistance from abroad. On the demand side, excess liquidity has been driven by weak credit demand from the private sector, due to the uncertain business environment, declining coffee prices, cumbersome investment requirements, and the lack of infrastructure and readily available land.²⁷ In addition, insufficient liquidity management by the NBE and liquidity risks associated with an outdated payments system²⁸ contributed to the excess liquidity.

84. **The high level of liquidity imposes costs on the banking system and could hinder effective monetary management.** Banks receive no interest income from excess reserves, while paying interest on deposit liabilities other than demand deposits. Monetary policy tools of the NBE include (i) reserve and liquidity requirements; (ii) discount and repo facilities; (iii) open market

²⁴ Property Mortgaged or Pledged with Banks Proclamation (Proclamation No.97/1998). Under this proclamation, when a claim is not paid within the time stipulated in the contract, banks can sell the collateralized property by auction upon a prior notice of at least 30 days to the debtor and transfer the ownership to the buyer, notwithstanding the provisions of the Civil Code (requiring the court process). Banks are required to acquire collateralized property after two failed auctions.

²⁵ For example, at the CBE, a decision on the write-off of a loan has to be made by the Board, and all the legal actions have to be exhausted before the management presents the case to the Board.

²⁶ Banks report that inadequate information from borrowers related to poor bookkeeping often hinders extension of credit and has led to a reliance on collateral-based lending.

²⁷ The constitution stipulates that land is wholly administered (virtually owned) by the government. Land is leased to the public for a prespecified period, and transfer of land leasing rights is allowed. Banks accept urban land as collateral based on the leasing value, however, banks have never foreclosed land as it is owned by the government and the lease market is not active.

²⁸ Financial transactions are mostly settled based on papers and manual processing, and cash and checks are the dominant payment medium. There is no automated clearance system for interbank transactions and checks, and there are no “failure to settle” rules and arrangements.

operations (a treasury bill primary market); (iv) administrative placement of government bonds; (v) intervention in the foreign exchange market; and (v) adjustment of the minimum saving rate. The NBE has so far resorted to open market operations and a limited issuance of bonds but succeeded to reduce excess reserves only marginally and temporarily. However, excess liquidity has not so far been considered to be a major problem in macroeconomic management as fluctuations in overall inflation have been driven mainly by food price developments, core inflation has remained low, and credit expansion to the private sector has been weak. Nonetheless, looking ahead, the development of effective mechanisms to control liquidity will be important to ensuring excess liquidity does not endanger macroeconomic stability.

85. **Saving and lending rates are characterized by nominal rigidity and have followed the minimum saving rate (Table V.4).** In March 2002, the NBE lowered the minimum saving rate from six to three percent in response to deflation in 2000/01-2001/02. Time deposit rates and minimum lending rates have been lowered by commercial banks by the same magnitude, although maximum lending rates remained unchanged. 91-day treasury bill rates have been consistently lower than the minimum saving rate, reflecting the excess liquidity of banks. Nominal saving and lending rates have remained almost unchanged irrespective of overall price developments, although real interest rates based on nonfood inflation have been relatively stable and positive.

Nonbanks

Microfinance institutions (MFIs)

86. **The micro-finance sector has grown appreciably, although large credit demands remain unmet.** Since 1996, 22 licensed MFIs have been established. Five are partially owned by regional governments, while the others are owned by local nongovernment organizations (NGOs) and individuals. The number of active clients reached roughly 2.2 million in January 2001, and the largest two—Amhara Credit & Savings Institutions S.C. and Dedebit Credit & Savings Institutions S.C.—rank among the largest in Africa. On average, 57 percent of the clients are women, and 75 percent are in rural areas (only four MFIs focus on urban areas). Loans outstanding amounted to Br 508 million (0.9 percent of GDP or 3.3 percent of total loans in the banking system) at end-June 2003, and the accumulated saving reached Br 303 million (0.5 percent of GDP or 1.1 percent of total deposits in the banking system). The average loan size is small at around Br 870. The loan recovery rate is reportedly high, averaging around 95 percent, reflecting an effective group guarantee scheme. The lending rate ranges from 12 to 24 percent, while the saving rate ranges from 6 to 8 percent. Despite expansion since 1996, it is estimated that credit demand by the rural poor amounted to Br 2.6 billion in 1999, compared with Br 285 million in loans outstanding by MFIs, and an estimated rural credit outstanding by commercial banks of about Br 490 million, leaving unmet demand around Br 1.8 billion (3.4 percent of GDP).²⁹

²⁹ Renee, Amha, Tesfaye, Yohanes, and Kurende (2000), “Enhancing Rural Financial Intermediation.”

Table V.4. Ethiopia: Interest Rate Developments, 1997/98-2002/03
(In percent per annum; end of period, unless otherwise indicated)

	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
	June	June	June	June	June	June
Deposit rates						
Savings deposits 1/	6.0	6.0	6.0	6.0	3.0	3.0
Time deposits 2/	6.8	6.4	6.3	6.6	3.5	3.7
Lending rates						
Minimum	10.5	10.5	10.5	10.5	7.5	7.5
Maximum	12.0	13.0	13.5	13.5	13.0	13.0
Treasury bill yield 3/	3.1	4.8	2.9	3.0	0.2	1.3
Memorandum items:						
Interest margin (maximum lending rate - saving rate)	6.0	7.0	7.5	7.5	10.0	10.0
Inflation rate (12-month period average)	3.9	4.8	6.2	-5.2	-7.2	15.1
Real interest rates						
Savings deposits	2.1	1.2	-0.2	11.2	10.2	-12.1
Time deposits	2.9	1.6	0.2	11.8	10.7	-11.3
Lending rates (minimum)	6.6	5.7	4.3	15.7	14.7	-7.6
Lending rates (maximum)	8.1	8.2	7.3	18.7	20.2	-2.1
Treasury bill yield	-0.8	0.0	-3.2	8.2	7.5	-13.8
Nonfood inflation rate (12-month period average)						
Nonfood inflation rate (12-month period average)	3.4	-2.0	1.8	4.9	1.6	1.6
Real interest rates						
Savings deposits	2.6	8.0	4.2	1.1	1.4	1.4
Time deposits	3.4	8.3	4.5	1.7	1.9	2.1
Lending rates (minimum)	7.1	12.5	8.7	5.6	5.9	5.9
Lending rates (maximum)	8.6	15.0	11.7	8.6	11.4	11.4
Treasury bill yield	-0.3	6.8	1.1	-1.9	-1.4	-0.3

Source: National Bank of Ethiopia (NBE).

1/ Minimum rate set by the NBE.

2/ Maturity of 1-2 years.

3/ 91-day bill; at auction.

Securities

87. **The securities markets are at the initial stage of development.** There is a treasury bill primary market with maturities of 28 days, 91 days, and 182 days. Government securities outstanding are equivalent to 38.3 percent of GDP at end-2002/03 (with the T-bills amounting to 15.4 percent and bonds to 22.9 percent) (Table V.5). The 91-day T-bill market is the largest, amounting to 57 percent of total T-bills outstanding. Domestic fiscal financing needs are met through the issuance of T-bills and direct advances from the NBE (currently bearing 4 percent interest), and only a limited volume of government bonds has been issued.³⁰ The NBE has been

³⁰ Major developments in the past include (i) conversion by the NBE of direct advances to noninterest bearing bonds at end-1999/2000 by about Br 8.5 billion; (ii) issuing a bond in November 2000 by Br 3 billion to reduce the excess reserves of commercial banks, namely the CBE; and (iii) retirement of a two-year bond and conversion to 91-day T-bills in December 2002 by

(continued)

trying to absorb some of the excess liquidity in the banking system through auctioning T-bills in excess of government needs,³¹ although the impact on the level of excess liquidity has been marginal.

Table V.5. Ethiopia: Government Domestic Debt, 1992/93-2002/03
(In millions of birr, unless otherwise indicated)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
Gross domestic debt	10,964	11,910	12,096	12,727	12,348	13,510	15,142	21,688	23,041	24,759	26,488
Banks	10,586	11,532	11,324	11,750	10,965	12,152	13,615	20,186	21,272	23,404	25,132
Nonbanks	378	378	772	977	1,383	1,358	1,527	1,502	1,769	1,354	1,356
Government securities	5,634	5,634	5,712	6,121	5,652	5,581	6,737	14,678	19,093	20,183	21,815
Treasury bills	561	559	824	1,266	925	1,088	2,300	1,626	3,227	4,398	8,789
Banks	561	559	561	781	26	159	1,194	545	1,854	3,406	7,794
Nonbanks	0	0	263	485	899	929	1,106	1,082	1,373	993	995
Government bonds	5,073	5,075	4,888	4,855	4,726	4,493	4,437	13,052	15,866	15,784	13,027
Banks	4,695	4,697	4,379	4,362	4,243	4,064	4,016	12,631	15,471	15,423	12,665
Nonbanks	378	378	509	492	484	429	421	421	395	362	362
Direct advances	5,329	6,275	6,384	6,606	6,696	7,929	8,405	7,010	3,948	4,576	4,673
Banks	5,329	6,275	6,384	6,606	6,696	7,929	8,405	7,010	3,948	4,576	4,673
Nonbanks	0	0	0	0	0	0	0	0	0	0	0
Government deposits	1,100	1,352	2,266	2,113	2,167	2,739	2,838	4,427	5,728	7,136	7,277
Banks	1,100	1,352	2,266	2,113	2,167	2,739	2,838	4,427	5,728	7,136	7,277
Nonbanks	0	0	0	0	0	0	0	0	0	0	0
Net domestic debt	9,864	10,558	9,829	10,614	10,181	10,771	12,304	17,262	17,313	17,622	19,211
Banks	9,486	10,180	9,058	9,637	8,798	9,413	10,777	15,759	15,544	16,268	17,855
Nonbanks	378	378	772	977	1,383	1,358	1,527	1,502	1,769	1,354	1,356
	(In percent of GDP)										
Memorandum items:											
Gross domestic debt	41.1	42.0	35.7	33.5	29.8	30.1	31.0	40.8	42.5	47.7	46.4
Banks	39.7	40.7	33.4	31.0	26.4	27.1	27.9	38.0	39.2	45.1	44.0
Nonbanks	1.4	1.3	2.3	2.6	3.3	3.0	3.1	2.8	3.3	2.6	2.4
Government securities	21.1	19.9	16.9	16.1	13.6	12.4	13.8	27.6	35.2	38.9	38.2
Treasury bills	2.1	2.0	2.4	3.3	2.2	2.4	4.7	3.1	6.0	8.5	15.4
Banks	2.1	2.0	1.7	2.1	0.1	0.4	2.4	1.0	3.4	6.6	13.7
Nonbanks	0.0	0.0	0.8	1.3	2.2	2.1	2.3	2.0	2.5	1.9	1.7
Government bonds	19.0	17.9	14.4	12.8	11.4	10.0	9.1	24.5	29.3	30.4	22.8
Banks	17.6	16.6	12.9	11.5	10.2	9.1	8.2	23.7	28.5	29.7	22.2
Nonbanks	1.4	1.3	1.5	1.3	1.2	1.0	0.9	0.8	0.7	0.7	0.6
Direct advances	20.0	22.2	18.8	17.4	16.1	17.7	17.2	13.2	7.3	8.8	8.2
Banks	20.0	22.2	18.8	17.4	16.1	17.7	17.2	13.2	7.3	8.8	8.2
Nonbanks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government deposits	4.1	4.8	6.7	5.6	5.2	6.1	5.8	8.3	10.6	13.7	12.7
Banks	4.1	4.8	6.7	5.6	5.2	6.1	5.8	8.3	10.6	13.7	12.7
Nonbanks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic debt	37.0	37.3	29.0	28.0	24.6	24.0	25.2	32.5	31.9	33.9	33.7
Banks	35.6	35.9	26.7	25.4	21.2	21.0	22.1	29.6	28.7	31.3	31.3
Nonbanks	1.4	1.3	2.3	2.6	3.3	3.0	3.1	2.8	3.3	2.6	2.4

Source: Ethiopian authorities.

Br 3 billion. The sharp increase of government debt in 1999/2000 is related to the hike in domestic finances due to the border conflict with Eritrea.

³¹ The NBE uses the proceeds from these augmented T-bills to repay government direct advances of the past. This transaction is in essence a transfer of credit to the government from the NBE to banks and nonbanks.

Insurance and pension sector

88. **The insurance and pension sector is underdeveloped.** The insurance sector consists of one large state-owned company, with a market share of 50 percent, and eight small privately owned companies, which have been established since 1994. Nonlife insurance is the main business, and life insurance is fairly limited. There is no compulsory insurance for vehicles or health coverage for workers. In the pension sector, two pension funds exist under the Social Security Authority, serving permanent government employees and military personnel, including those of public enterprises and regional and local governments.

B. Financial Sector Reforms

Commercial Bank of Ethiopia

89. **The authorities have commenced implementing a financial restructuring plan for the CBE in line with the recommendations by a joint IMF/World Bank technical assistance mission.** The restructuring plan includes: (i) a time-bound plan for reducing NPLs; (ii) a business plan to keep the risk-weighted capital adequacy ratio over 10 percent (projected to increase to 12.5 percent by end-June 2007) with no capital injection envisaged from the government; (iii) strengthening of credit risk and portfolio management, with the assistance of consultants from the Bank of Scotland, through improved credit guidelines, organizational restructuring, and staff training; and (iv) the establishment of a mechanism to follow up the implementation of the restructuring plan.

National Bank of Ethiopia

90. **The NBE is not sufficiently autonomous.** The Board of the NBE is dominantly occupied by incumbent ministers of the economy and the economic advisor to the Prime Minister. The tenure of the Board members and the conditions of their removal from the Board are not specified so that they could be removed at any time at the government's will for unspecified reasons. The Governor of the NBE is only accountable to the Council of Ministers and not to the parliament or the public. In addition, the objectives of the NBE are not clear and prioritized³².

91. **The banking supervision of the NBE lacks a strong legal basis and sufficient staffing.** The banking supervision proclamation does not have a sufficiently strong clause for dealing promptly with insolvent and failing banks.³³ The Supervision Department has only 30 staff positions and has been suffering from a loss of experienced staff, due mainly to insufficient

³² The NBE proclamation states that the NBE's primary purpose is "to foster monetary stability, a sound financial system, and such other credit and exchange conditions as are conducive to the balanced growth of Ethiopia."

³³ Taking over the ownership of a commercial bank involves a court process.

remuneration. On-site inspections, to be conducted once a year, have not been conducted as frequently as required, with the number of inspections having reached just 30 in total since 1996.

92. **The authorities commenced implementing, in December 2003, a restructuring plan for the NBE based on a study by KPMG**, which will continue into 2004-05. Actions include (i) enacting the revised NBE and banking supervision proclamations, following a discussion by the Council of Ministers; and (ii) implementing the reorganization of the NBE, following the completion of an ongoing study on pay scale and job grading.

Other banking reforms

93. **Restructuring of other state-owned banks is ongoing.** The privatization of the CBB has been on the government reform agenda since 2001, but it has been delayed on a number of occasions as a result of repeated failures to complete unqualified audited accounts. Regarding the DBE, a financial restructuring was implemented during 2003 through a recapitalization and a limited write-off of old NPLs. However, its financial condition remains weak, and NPLs amounted to 51 percent of total loans at end-June 2003.

C. Regional Comparison

94. This section compares Ethiopia's financial sector development and reform with that of a number of countries in east Africa. Countries selected for comparison with Ethiopia are Kenya, Uganda, and Tanzania, and the comparison focuses on the structure of financial sector, financial market development, financial soundness, prudential regulations, and reform experience.

Structure of financial sector

95. **The banking sector in Ethiopia is relatively concentrated (Table V.6).** The state-owned CBE is in a near-monopoly position, while the asset share of the largest bank in neighboring countries is much lower. There are no foreign banks in Ethiopia, while the presence of foreign banks in neighboring countries is quite high. The share of the largest three banks are relatively high in all countries, but more equally distributed shares suggest that competitive forces are stronger in neighboring countries.

Table V.6. Ethiopia: Structure of Banking System in the Region 1/
(In percent, unless otherwise indicated)

	Ethiopia	Kenya	Uganda	Tanzania
Structure of banking system				
Number of banks 2/	9	46	15	21
<i>Of which:</i> state-owned banks, incl. minority shareholding 3/	3	5	1	2
privatized public banks	0	0	1	1
foreign banks	...	13	11	9
Share of assets of the largest bank	76.0	20.5	...	...
Share of loans of the largest bank	53.6	14.2	6.9	16.4
Share of deposits of the largest bank	75.4	5.9	21.2	44.7
Share of assets of state-owned banks, incl. minority shareholding	83.9	26.3	...	19.0
Share of loans of state-owned banks, incl. minority shareholding	72.7	...	...	...
Share of deposits of state-owned banks, incl. minority shareholding	80.3	...	...	...
Share of assets of foreign banks, incl. minority shareholding	...	50.5	73.0	58.7
Share of loans of foreign banks, incl. minority shareholding	...	33.9	73.7	77.8
Share of deposits of foreign banks, incl. minority shareholding	...	47.0	83.0	60.5
Share of assets of largest three banks	86.3	47.5	...	45.8

Sources: Authorities of Ethiopia, Kenya, Uganda, and Tanzania; IMF, *International Financial Statistics*.

1/ Based on the latest available actual data: end-2002/03 for Ethiopia, 2002 for Kenya, Uganda and Tanzania

2/ Including specialized banks, e.g. the Development Bank of Ethiopia (DBE).

3/ Commercial Bank of Ethiopia (CBE), Construction and Business Bank (CBB), and Development Bank of Ethiopia (DBE) for Ethiopia; Kenya Commercial Bank (KCB), National Bank of Kenya (NBK), Co-operative Bank, Consolidated Bank, and Industrial Development Bank (IDB) for Kenya; Uganda Commercial Bank Limited (UCBL) for Uganda (10 percent retained by the government following the privatization will be floated by 2004); National Microfinance Bank (NMB), and Cooperative and Rural Development Bank (CRDB) for Tanzania.

Financial market development

96. Ethiopia's financial market is relatively deep, and interest spreads are the narrowest in the region (Table V.7). While currency as a share of broad money is similar to that of the other countries, broad money and bank assets in percent of GDP are highest in Ethiopia. Although a large portion of bank assets is occupied by credit to the government in Ethiopia, credit to nongovernment is relatively high, compared with neighboring countries, despite the fact that private investment is not particularly high within the region. A salient feature of Ethiopia in the region is that nominal and real lending rates are lowest, and that interest spreads between saving and lending rates are narrowest. The narrow interest spread despite a lack of competition in Ethiopia suggests less profit orientation compared with other countries.

Table V.7. Ethiopia: Financial Market Development 1/
(In percent, unless otherwise indicated)

	Ethiopia	Kenya	Uganda	Tanzania
Financial market development				
Broad money (in percent of GDP)	53.6	37.4	20.3	15.5
Money velocity	1.9	2.7	4.9	6.4
Money multiplier	2.4	4.5	3	3
Total assets of banks (in percent of GDP)	97.7	49.9	24.1	30
Government securities (in percent of GDP)	38.3	18.6	2.1	8
<i>Of which:</i> treasury bills	15.4	7.5	...	5.8
Net claims on the government (in percent of GDP)	30.5	11.2	3.7	5
Credit to nongovernment (in percent of GDP)	22.6	21.5	7	8.1
Private investment (in percent of GDP)	10.7	6.5	17.2	13.6
Currency (in percent of broad money)	21.9	18	24	25.2
Nominal lending rate (average over last 5 years)	9.8	19.9	16.4	18.9
Nominal saving rate (average over last 5 years)	5.6	6.8	8.5	5
Interest spread (average over last 5 years)	4.2	13.1	7.9	13.9
treasury-bill rate (average over last 5 years)	2.4	10.2	10.9	6.8
Real lending rate (average over last 5 years)	7.1	13.4	12.4	12.9
Real saving rate (average over last 5 years)	2.9	0.3	4.5	-1
Real treasury-bill rate (average over last 5 years)	-0.3	3.7	6.9	0.8
Memorandum items:				
Real GDP growth rate (average over last 5 years)	3.3	1	6	5.5
Real GDP growth rate (standard deviation; last 5 years)	4.6	0.6	1.2	1
Inflation rate (average over last 5 years)	2.7	6.5	4	6
Inflation rate (standard deviation; last 5 years)	8.4	3.4	3.4	1.8
Nonfood inflation rate (average over last 5 years)	1.6	...	...	...
Nonfood inflation rate (standard deviation; last 5 years)	2.4	...	...	...
Nominal lending rate (standard deviation; last 5 years)	1.3	2.5	6.3	3.3
Nominal saving rate (standard deviation; last 5 years)	1.5	2.1	1.8	2.4
Nominal treasury-bill rate (standard deviation; last 5 years)	1	4.2	4.4	3.1
Real lending rate (standard deviation; last 5 years)	8.9	4	4.8	2.4
Real saving rate (standard deviation; last 5 years)	8.9	4	3.9	1
Real treasury-bill rate (standard deviation; last 5 years)	8.6	6.1	5.7	1.9

Sources: Authorities of Ethiopia, Kenya, Uganda, and Tanzania; IMF, *International Financial Statistics*.

1/ Based on the latest available actual data: end-2002/03 for Ethiopia, Kenya, Uganda, and Tanzania.

Financial soundness indicators

97. **NPLs in Ethiopia are higher than in neighboring countries, and capital is low (Table V.8).** Ethiopia and Kenya have a much higher NPL-to-loan ratio than Uganda and Tanzania, where financial restructuring has progressed. Capital adequacy is lower in Ethiopia, whereas neighboring countries have higher capital, owing to the progress in financial restructuring, higher interest spreads, and the presence of well-capitalized foreign banks. Nonetheless, the profitability of Ethiopia's banks is comparable in the region. The loan-to-deposit ratio is highest in Ethiopia,

indicating that financial intermediation is relatively well functioning. While interest margins are low in Ethiopia, noninterest expenses to income are limited, partly reflecting low remuneration at state-owned banks.

Table V.8. Ethiopia: Financial Soundness Indicators in the Region
(In percent, unless otherwise indicated)

	Ethiopia	Kenya	Uganda	Tanzania
Financial soundness 1/				
Nonperforming loans (NPLs) (in percent of total loans)	40.5	27.7	3.6	9.2
<i>Of which:</i> public banks	51.9	64.3	...	...
Capital adequacy ratio (to risk-weighted assets)	11.9	17.2	23.7	23.1
<i>Of which:</i> public banks	10.4	9.8	...	...
Return on assets	1.9	1.6	3.3	1.3
<i>Of which:</i> public banks	2.1	0.6	...	...
Return on equity	29.4	17.8	33.5	17.6
<i>Of which:</i> public banks	40.4	11.8	...	...
Loan-to-deposit ratio	63.8	76.7	30.4	34.1
<i>Of which:</i> public banks	41.3	81.4	...	...
Sectoral concentration (sector with highest loan share)	Trade (25%)	Manufacturing (19%)	Industry (32%)	Industry (21%)
<i>Of which:</i> public banks	...	...	...	...
Claims on government (in percent of assets)	19.7	17.5	32.8	12.4
<i>Of which:</i> public banks	22.6	...	...	...
Loans and advances (in percent of assets)	27.6	36.5	23.1	25.4
<i>Of which:</i> public banks	23.9	...	...	...
Liquid assets (in percent of assets)	37.2	33.4	66.1	58
<i>Of which:</i> public banks	39.6	...	...	...
Excess reserves (in percent of deposits)	12.8	...	...	...
<i>Of which:</i> public banks	12.9	...	...	...
Interest margin to gross income	34.3	46.2	55.2	41.6
<i>Of which:</i> public banks	32.5	...	...	...
Noninterest expenses to gross income	30.9	58.3	52.3	60.8
<i>Of which:</i> public banks	25.5	72.6	...	...

Sources: Authorities of Ethiopia, Kenya, Uganda, and Tanzania; IMF, *International Financial Statistics*.

1/ Only commercial banks.

Prudential regulations

98. **Prudential regulations in Ethiopia are comparable in the region (Table V.9).** Following a strengthening of prudential regulations, in particular during the recent years, key prudential norms are in line with regional and international practices. The treatment of collateral is conservative in Tanzania in that no collateral values can be deducted from loans outstanding for provisioning purpose.

Financial sector reforms

The pace of reform has been slower than in neighboring countries (Table V.10). Uganda and Tanzania implemented a comprehensive financial restructuring of the large state-owned banks, which contributed to an improved health of the overall financial sector. These banks were subsequently privatized. In Tanzania, the largest commercial bank was split into a large business-

oriented bank and a microfinance bank that is still state-owned. These developments, as well as foreign bank entry that was allowed in 1991, contributed to a more competitive banking sector. Ethiopia just started a comprehensive financial restructuring of the CBE, but the market competition is still limited as the near monopoly status of the CBE has not been addressed yet.

Table V.9. Ethiopia: Prudential Regulations in the Region

	Ethiopia	Kenya	Uganda	Tanzania
Prudential regulations				
Minimum capital adequacy requirement	8 percent of total capital (since 1994)	8 percent of core, and 12 percent of total capital (since 2000).	8 percent of core, and 12 percent of total capital (since 1999)	10 percent of total capital
NPL classification	5 categories (pass: overdue less than 30 days; special mention: overdue 30-90 days; substandard: 90-180 days; doubtful: 180-360 days; loss: more than 360 days); NPLs: overdue 90 days and more. Adopted in September 2002, and fully effective in January 2004.	5 categories (normal risk, watch, substandard, doubtful, and loss with the same definition as Ethiopia); NPLs: overdue 90 days and more.	4 categories (performing: overdue less than 180 days; substandard: overdue 180 days-1 year; doubtful: overdue 1-2 years; and loss: overdue more than 2 years); NPLs: overdue 180 days and more. Loss loans need to be written off within 3 months after categorized as loss.	5 categories
Provisioning requirement	1 percent for pass; 3 percent for special mention; 20 percent for substandard; 50 percent for doubtful; and 100 percent for loss.	1 percent for normal risk and watch; no specific provision but interest to be suspended for substandard; 100 percent for doubtful and loss.	Banks encouraged to make 1 percent general provisions for performing loans; 20 percent for substandard; 50 percent for doubtful; and 100 percent for loss.	....
Collateral	Net recovery value of collaterals are deducted from loan outstanding for provisioning. Land is accepted as collateral against land lease certificate.	Net recovery value of collaterals are deducted from loan outstanding for provisioning.	No collateral is allowed to be deducted from loan outstanding for provisioning, although well-secured loans can be classified as performing.	No collateral is allowed to be deducted from loan outstanding for provisioning.

Sources: Authorities of Ethiopia, Kenya, Uganda, and Tanzania; IMF, *International Financial Statistics*.

Table V.10. Ethiopia: Financial Sector Reforms in the Region

	Ethiopia	Kenya	Uganda	Tanzania
Financial sector reforms				
Financial restructuring	Financial restructuring of the largest state-owned Commercial Bank of Ethiopia (CBE) commenced in Nov. 2003 with NPL ratio to be reduced to below 20 percent by 2006/07, while maintaining capital adequacy ratio above 10 percent.	State-owned National Bank of Kenya (NBK) was bailed out in 1998.	Uganda Commercial Bank Limited (UBCL) was financially restructured prior to the privatization in 2002.	The new National Bank of Commerce (NBC) established after breaking up in 1997 was financially restructured, including recapitalization, prior to the privatization in 2000.
Bank closures	...	...	Five banks have been closed ... since 1998.	
Privatization	Construction and Business Bank (CBB) is to be privatized soon.	...	UBCL was privatized in 2002.	The new NBC established after breaking up in 1997 was privatized in 2000.
Breaking up	...	...	...	NBC was split in 1997 into the new NBC focusing on large and corporate customers and the National Microfinance Bank (NMB) serving rural and small urban business.
Foreign bank entry	Not allowed.	Since banking business was allowed.	Since banking business was allowed.	1991

Sources: Authorities of Ethiopia, Kenya, Uganda, and Tanzania; IMF, *International Financial Statistics*.

D. Future Reforms

99. **The authorities' financial sector reform and development strategy needs updating and further articulation.** The authorities developed a financial sector strategy in March 1998 with two objectives: (i) to link the financial sector to the long-term agricultural-development-led industrialization; and (ii) to bring about the development of a sound financial system that can sustain financial liberalization. The strategy focuses on (i) mobilizing savings; (ii) modernizing commercial banking; (iii) creating a securities market; (iv) strengthening prudential banking; (v) developing nonbank financial institutions; and (vi) conducting policy-based lending. While the strategy covers a wide range of issues, it lacks an action plan with a clear timeframe as well as well prioritized and sequenced concrete measures to be taken. The gradual reforms adopted over the last decade, following a long period of state control suggest a cautious attitude by the government toward any radical and fast-paced reforms and difficulties in building a consensus in the country. Nonetheless, as discussed in the ex-post assessment for Ethiopia, a more robust and speedy reform effort would likely strengthen growth potential.

Banking sector

100. **Persevering with the ongoing financial restructuring of the CBE is the highest priority.** The financial sector should be ready for further reforms as the financial restructuring of the CBE progresses. At the same time, the privatization of the CBB needs to be expedited, and a further restructuring plan of the DBE developed and implemented.

101. **The near-monopoly status of the CBE should be addressed.** While its share in the sector has been gradually declining, its dominance severely weakens the competition in the sector. Allowing foreign bank entry is a solution not only to realize a more dynamic financial sector, but to bring a wider variety of financial services to the public and improving the soundness to the sector.

102. **Structural impediments for credit expansion to the private sector need to be removed.** These include vulnerability of the economy to exogenous shocks, insecurity, remaining investment requirements, lack of infrastructure, readily available land, and borrowers' information. A recent industry survey indicated that a lack of access to credit is the biggest obstacle in doing business. While the recently strengthened prudential regulations restrained bank lending, efforts to ease structural bottlenecks for credit expansion to the private sector need to be enhanced. Coupled with an improvement in the payments and settlement system, this would help reduce excess liquidity in the banking system.

103. **The interest rate policy may need to be revisited.** Adjusting the reserve requirement reduces excess reserves without alleviating the burden on banks, and open market operation or administrative placement of bonds can only temporarily reduce excess reserves. The current minimum saving rate has been consistently higher than the market-determined yield of treasury bills, indicating that the saving rate to be offered by commercial banks would be lower should the minimum saving rate be abolished. Such a policy could lead to lower lending rates and raise credit demand from the private sector, both alleviating the excess liquidity in the banking system.

Nonbanks

104. **The regulatory framework of the MFIs sector needs to be improved.** The maximum loan size is set by the NBE at Br 5,000, compared with Br 20,000 of the reported minimum loan size offered by commercial banks, leaving a gap in credit size to medium-sized borrowers. The maximum loan maturity ceiling is set at one year, limiting the use of finance to working capital and precluding investment-related finances. While a large portion of resources originates from donors and international NGOs, foreign-owned MFIs are not allowed – this weakens the governance of MFIs by breaking the link between financiers and owners. Only a group guarantee (composed of five members) is allowed, and no physical collateral is accepted, limiting tailored credit services. Although MFIs comply with few prudential norms under the MFIs' proclamation, the NBE has not taken action. The NBE has conducted only seven on-site inspections of MFIs to date.

105. **The MFI proclamation needs to be amended,**³⁴ in particular (a) allowing foreign bank entry for the future; (b) allowing MFIs to accept collateral in addition to the group guarantee; (c) limiting the NBE's inspection only to MFIs with savings in excess of Br 1 million (tiered approach) in view of the NBE's capacity constraints; (d) recognizing that the NBE "may", and not "shall", fix the maximum loan size; (e) introducing sanctions for noncompliance; and (f) establishing a legal basis for dealing swiftly with insolvent MFIs without a court process required under the Commercial Code.

106. **Developing a secondary market for T-bills and extending the maturity is a priority.** Banks have indicated that, under the volatile economic environment of Ethiopia, investing in a long-term bond with a fixed rate was difficult, and that they would prefer a variable and short-term bond. This suggests a need for a secondary T-bill market. Extending the maturity of T-bills to the level of bonds, and denominating these in small amounts or values, e.g. around the level of the average T-bills auction, would attract institutional investors.

107. **Insurance and pensions need to be promoted further.** In view of the weak social security system in the private sector, life insurance could play a supporting role as a social safety net.

Supervision

108. **Financial sector supervision and the independence of the supervision need to be enhanced.** There is a need to strengthen the supervision at the NBE as evidenced by a long-standing insufficiency and erosion of staff and infrequent on-site inspections. Supervision by the NBE, in particular on state-owned banks, has been limited and rarely gone beyond monitoring. Supervision of MFIs and insurance companies is virtually nonexistent.

Judiciary system

109. **A faster litigation process would help the banking system.** As a result of slow court processes, there are apparently a large number of cases under litigation, in particular for the uncollateralized portions of loans or uncollateralized loans, related to the bankruptcy of borrowers. While banks can write off loans even if they are still in the court process, the backlog of court cases diverts attention and resources of bank and management away from the core business. Establishing a special tribunal for bankruptcy resolution is worth considering.

³⁴ As recommended in the study on the NBE restructuring by the KPMG.

Table 1. Ethiopia: Gross Domestic Product by Economic Activity at Factor Cost, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr at 1980/81 prices)					
Agriculture and allied activities	6,874	7,025	7,831	7651	6687
Industry	1,701	1,731	1,818	1,923	2,012
Mining and quarrying	75	83	90	98	102
Manufacturing	688	713	736	773	812
Small-scale industry and handicrafts	294	302	317	324	325
Electricity and water	226	235	243	260	271
Construction	418	399	431	468	502
Services	6,720	7,356	7,705	8,058	8,242
Distribution services	2,254	2,423	2,550	2,663	2,749
Trade, hotels, and restaurants	1,344	1,397	1,469	1,519	1,528
Transportation and communications	910	1,027	1,081	1,144	1,221
Other services	4,466	4,933	5,155	5,395	5,493
Banking, insurance, and real estate	1,046	1,144	1,207	1,204	1,259
Public administration and defense	2,138	2,449	2,513	2,665	2,617
Education	356	388	439	487	550
Health	188	187	202	216	218
Domestic and other	738	766	795	823	849
Total GDP at 1980/81 factor costs	15,294	16,112	17,354	17,632	16,941
<i>Of which</i>					
Nonagricultural GDP	8,421	9,088	9,523	9,981	10,254
(Annual percentage change)					
Agriculture and allied activities	3.8	2.2	11.5	-2.3	-12.6
Industry	8.6	1.8	5.0	5.8	4.6
Mining and quarrying	9.5	9.5	9.0	9.0	4.1
Manufacturing	17.1	3.6	3.3	5.0	5.0
Small-scale industry and handicrafts	6.6	2.8	5.1	2.2	0.1
Electricity and water	1.3	3.9	3.4	7.1	4.3
Construction	1.5	-4.5	8.0	8.4	7.4
Services	7.7	9.5	4.7	4.6	2.3
Distribution services	3.5	7.5	5.2	4.4	3.2
Trade, hotels, and restaurants	6.4	3.9	5.2	3.4	0.6
Transportation and communications	-0.5	12.8	5.3	5.8	6.7
Other services	9.9	10.5	4.5	4.6	1.8
Banking, insurance, and real estate	4.2	9.4	5.5	-0.3	4.6
Public administration and defense	15.7	14.5	2.6	6.1	-1.8
Education	9.0	8.9	13.1	10.9	13.0
Health	6.7	-0.6	8.0	7.1	0.8
Domestic and other	4.0	3.8	3.8	3.5	3.2
Total GDP at 1980/81 factor costs	6.0	5.4	7.7	1.6	-3.9
<i>Of which</i>					
Nonagricultural GDP	7.8	7.9	4.8	4.8	2.7

Source: Ministry of Finance and Economic Development.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

Table 2. Ethiopia: Expenditure on Gross Domestic Product at Current Market Prices, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr)					
GDP at current market prices	48,803	53,190	54,211	51,933	57,077
Gross domestic expenditure	56,042	61,146	62,187	61,249	68,154
Consumption	47,773	52,714	52,541	50,636	56,479
Private	38,593	40,661	43,426	40,621	45,576
Public	9,181	12,053	9,115	10,015	10,904
Investment	8,268	8,432	9,646	10,614	11,675
Private	4,327	5,678	5,039	4,660	5,698
Public	3,941	2,754	4,607	5,954	5,976
Resource gap	-7,238	-7,956	-7,976	-9,317	-11,077
Exports of goods and nonfactor services	6,894	8,020	8,162	8,395	9,778
Imports of goods and nonfactor services	-14,132	-15,976	-16,139	-17,712	-20,855
Memorandum items:					
Gross domestic saving	1,030	476	1,670	1,297	598
Private	1,437	3,031	608	903	352
Public	-408	-2,555	1,061	394	245
Net factor income	-394	-490	-425	-339	-468
Net private transfers	2,182	3,346	3,161	2,978	4,248
Net official transfers	1,605	2,371	3,295	3,713	4,633
Gross national saving (including official grants)	4,423	5,703	7,701	7,648	9,011
Private	3,846	6,506	3,928	3,984	4,750
Public	577	-803	3,773	3,664	4,261
Foreign saving (excluding official transfers)	-5,451	-5,101	-5,240	-6,678	-7,297
GNP at current market prices	48,409	52,700	53,786	51,594	56,609
(In percent of GDP)					
Gross domestic expenditure	114.8	115.0	114.7	117.9	119.4
Consumption	97.9	99.1	96.9	97.5	99.0
Private	79.1	76.4	80.1	78.2	79.8
Public	18.8	22.7	16.8	19.3	19.1
Investment	16.9	15.9	17.8	20.4	20.5
Private	8.9	10.7	9.3	9.0	10.0
Public	8.1	5.2	8.5	11.5	10.5
Resource gap	-14.8	-15.0	-14.7	-17.9	-19.4
Exports of goods and nonfactor services	14.1	15.1	15.1	16.2	17.1
Imports of goods and nonfactor services	-29.0	-30.0	-29.8	-34.1	-36.5
Memorandum items:					
Gross domestic saving	2.1	0.9	3.1	2.5	1.0
Private	2.9	5.7	1.1	1.7	0.6
Public	-0.8	-4.8	2.0	0.8	0.4
Net factor income	-0.8	-0.9	-0.8	-0.7	-0.8
Net private transfers	4.5	6.3	5.8	5.7	7.4
Net official transfers	3.3	4.5	6.1	7.1	8.1
Gross national saving (including official grants)	9.1	10.7	14.2	14.7	15.8
Private	7.9	12.2	7.2	7.7	8.3
Public	1.2	-1.5	7.0	7.1	7.5
Foreign saving (excluding official transfers)	-11.2	-9.6	-9.7	-12.9	-12.8
GNP at current market prices	99.2	99.1	99.2	99.3	99.2

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

2/ GDP at current market prices match authorities' figures; expenditure data depart from these to ensure consistency with Fund staff estimates of the current account.

Table 3. Ethiopia: Estimates of Agricultural Production and Cultivated Area of Major Crops, 1998/99-2002/03 1/

	1998/99		1999/00		2000/01		2001/02		2002/03	
	Cultivated area	Total production	Cultivated area	Total production	Cultivated area	Total production	Cultivated area	Total production	Cultivated area	Total production
(Area in thousands of hectares; production in thousands of quintals)										
Cereals	7,460	79,577	6,747	80,126	7,637	96,910	7,066	90,541	6,870	68,010
Maize	1,696	25,852	1,407	26,854	1,720	33,059	1,674	30,518	1,404	20,382
Wheat	1,077	11,365	1,025	12,375	1,140	16,052	1,066	14,609	1,049	11,087
Teff	2,138	16,519	2,123	17,219	2,183	17,496	1,868	16,450	1,978	14,384
Sorghum	1,068	13,278	995	11,841	1,333	15,487	1,176	15,715	1,111	10,645
Barley	1,020	8,306	794	8,134	874	11,066	956	9,794	975	8,091
Millet	403	3,821	360	3,197	347	3,177	282	3,071	313	3,113
Oats	59	437	42	506	41	573	44	384	40	308
Rice							-	-	-	-
Pulses	896	7,636	1,061	10,413	1,247	11,094	1,158	10,851	1,118	8,444
Horsebeans	293	2,859	359	3,895	426	4,559	372	4,498	391	3,622
Chickpeas	168	1,410	185	1,672	212	1,763	195	1,849	144	1,155
Haricot beans	130	1,168	166	1,949	187	1,660	207	1,513	228	1,332
Field peas	142	1,001	152	1,212	205	1,474	204	1,543	220	1,448
Lentils	48	286	72	500	90	557	75	414	55	238
Vetch	95	788	111	1,077	114	1,001	85	929	54	532
Soya beans		0		0		0	-	-	-	-
Fenugreek	21	124	16	108	14	81	20	105	26	117
Gibto							-	-	-	-
Others	374	1,568	408	1,796	561	2,389	429	2,105	479	1,985
Neug	221	845	257	1,022	336	1,190	232	842	132	428
Linseed/flax	90	353	74	321	131	646	102	531	15	110
Rapeseed	10	84	20	139	25	147	15	169	4	16
Sunflower	6	25	5	37	11	65	5	38	19	207
Groundnuts	15	84	14	119	17	152	16	136	251	861
Sesame	32	177	38	158	42	189	59	389	58	363
Total	8,731	88,782	8,217	92,335	9,445	110,393	8,653	103,497	8,467	78,439
Cereals and pulses	8,356	87,214	7,809	90,539	8,884	108,004	8,224	101,392	7,988	76,454
(Annual percentage change)										
Cereals	18.7	10.6	-9.6	0.7	13.2	20.9	-7.5	-6.6	-2.8	-24.9
Pulses	3.4	3.9	18.4	36.4	17.5	6.5	-7.2	-2.2	-3.5	-22.2
Others	-1.5	-7.8	9.0	14.5	37.6	33.1	-23.6	-11.9	11.7	-5.7
Total	15.9	9.6	-5.9	4.0	15.0	19.6	-8.4	-6.2	-2.1	-24.2
Cereals and pulses	16.8	9.9	-6.6	3.8	13.8	19.3	-7.4	-6.1	-2.9	-24.6
(Index, 1995/96 = 100)										
Cereals	98.2	85.4	88.8	86.0	100.5	104.0	93.0	97.2	90.4	73.0
Pulses	97.6	92.9	115.6	126.7	135.9	135.0	126.1	132.1	121.8	102.8
Others	99.3	83.5	108.2	95.6	148.9	127.3	113.8	112.1	127.1	105.7
Total	98.2	86.0	92.4	89.4	106.2	106.9	97.3	100.2	95.2	76.0
Cereals and pulses	98.1	86.0	91.7	89.3	104.3	106.5	96.6	100.0	93.8	75.4

Source: Central Statistical Authority.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

Table 4. Ethiopia: Estimates of Coffee Production, Marketing, and Stocks, 1998/99-2002/03 1/
(In thousands of metric tons)

	1998/99	1999/00	2000/01	2001/02	2002/03
Opening stocks	191	152	144	130	124
Production	232	230	221	245	250
Domestic consumption	-98	-98	-100	-110	-110
Exports 2/	-105	-120	-85	-116	-137
Unwashed	-84	-87	-66	-78	-99
Washed	-21	-33	-19	-38	-38
Adjustments 3/	-68	-20	-50	-25	-28
Closing stocks	152	144	130	124	99

Source: Ethiopian Coffee and Tea Authority.

1/ Estimates (except exports) based on the findings of the Coffee Sector Survey; coffee year begins in October.

2/ As recorded on loading at port rather than at customs stations.

3/ Represents, among other factors, unofficial exports and handling losses.

Table 5. Ethiopia: Monthly Export and Arrival Volumes and Coffee Prices, October 2000-March 2004

		Export Volume	Arrival Volume	Estimated Producer Price 1/ Price 2/	Auction Price 2/ Price 2/	Export Unit Value 2/	ICO Composite Price 3/
		(Metric tons)	(Metric tons)	(Birr per metric ton)			
(In units indicated)							
2000/01	October	6,741	8,277	9,864	11,167	15,680	56
	November	6,538	6,341	9,252	10,494	15,237	52
	December	4,659	3,944	9,131	10,624	14,733	48
	January	3,585	11,359	9,347	11,414	16,377	49
	February	4,178	12,393	9,059	10,789	14,671	49
	March	6,810	13,271	8,209	9,655	15,018	49
	April	9,810	12,763	8,675	9,095	14,297	47
	May	9,629	18,404	8,985	10,440	14,196	49
	June	10,862	12,413	9,075	10,542	14,018	47
	July	9,763	8,849	8,532	9,839	15,018	43
	August	7,040	4,139	8,105	9,360	15,129	43
	September	5,474	2,991	7,661	8,748	13,896	41
2001/02	October	6,081	7,998	7,340	8,345	14,168	42
	November	4,529	9,408	6,976	8,813	13,808	44
	December	4,805	19,845	5,898	8,321	12,797	43
	January	5,041	18,877	5,418	7,230	13,465	43
	February	7,283	22,418	4,809	5,949	13,987	44
	March	11,299	26,667	5,028	6,021	11,958	49
	April	14,551	23,901	5,011	6,012	11,008	50
	May	18,090	16,878	5,009	6,084	11,158	47
	June	14,164	14,753	4,805	5,748	11,330	46
	July	13,978	15,181	4,368	5,197	10,575	45
	August	8,998	11,854	4,316	5,092	10,798	43
	September	7,537	9,883	4,234	4,856	9,410	48
2002/03	October	8,661	8,944	4,991	5,938	10,567	51
	November	6,718	17,054	6,321	8,363	10,536	55
	December	6,962	17,649	6,617	8,756	11,111	52
	January	6,444	15,082	5,874	7,902	11,480	54
	February	7,617	22,473	6,216	7,924	11,377	54
	March	12,604	26,610	6,201	7,554	12,267	50
	April	14,686	20,307	5,811	7,072	10,776	52
	May	15,315	18,374	6,411	7,771	10,604	53
	June	17,315	15,307	6,378	7,739	10,982	49
	July	18,056	12,157	6,847	8,181	11,266	51
	August	12,176	9,403	6,888	8,117	10,659	52
	September	10,060	8,356	6,769	8,023	11,004	54
2003/04	October	9,172	9,104	6,799	8,139	1,330	52
	November	5,187	10,244	7,447	9,861	1,314	50
	December	5,115	17,971	7,008	9,241	1,289	52
	January	4,936	20,002	8,044	10,348	1,450	59
	February	6,332	24,998	8,072	10,070	1,526	60
March	16,350	28,823	8,586	10,364	1,450	61	
(Annual average, based on coffee year) 4/							
1998/99		8,783	12,293	10,780	12,192	20,166	89
1999/2000		10,025	14,270	11,461	12,995	17,489	73
2000/01		7,091	9,595	8,825	10,181	14,856	48
2001/02		9,696	16,472	5,268	6,472	12,039	45
2002/03		11,385	15,976	6,277	7,778	11,052	52
(Annual percentage change, based on coffee year) 4/							
1998/99		-15.9	-4.0	-22.4	-21.8	-10.2	-22.8
1999/2000		14.1	16.1	6.3	6.6	-13.3	-17.8
2000/01		-29.3	-32.8	-23.0	-21.7	-15.1	-34.4
2001/02		36.7	71.7	-40.3	-36.4	-19.0	-5.1
2002/03		17.4	-3.0	19.2	20.2	-8.2	15.3

Source: Ethiopian Coffee and Tea Authority.

1/ Auction price less estimated transport and handling costs.

2/ For unwashed and washed coffee, combined (mostly unwashed) at Addis Ababa and weighted by same month's arrival.

3/ ICO is the International Coffee Organization; in U.S. cents per pound.

4/ October-September.

Table 6. Ethiopia: Approved Investment Projects, July 1992 - January 8, 2003 1/

	Number of Projects	Capital Cost 2/	Permanent Employment	Temporary Employment	Capital- Labor Ratio 3/	Average Project Employment 3/
(In units indicated)						
Agriculture, forestry, and fishing						
Approved	1,633	10,793	166,779	429,726	0.06	102
Implementation phase	131	1,461	27,771	14,523	0.05	212
Operational	605	3,283	24,839	349,376	0.13	41
Mining and quarrying						
Approved	61	679	3,716	123	0.18	61
Implementation phase	20	126	1,063	2	0.12	53
Operational	14	338	1,365	79	0.25	98
Manufacturing						
Approved	3,583	30,659	178,536	33,844	0.17	50
Implementation phase	597	7,271	33,661	5,176	0.22	56
Operational	1,159	6,249	37,134	22,014	0.17	32
Electricity supply						
Approved	37	11,010	1,445	932	7.62	39
Implementation phase	8	5,718	437	400	13.09	55
Operational	7	2,241	125	61	17.93	18
Construction						
Approved	596	10,306	70,412	17,622	0.15	118
Implementation phase	115	2,031	14,438	1,420	0.14	126
Operational	50	1,898	13,974	2,602	0.14	279
Construction machinery leasing						
Approved	956	7,391	23,607	901	0.31	25
Implementation phase	73	528	1,657	0	0.32	23
Operational	39	359	1,546	5	0.23	40
Real estate						
Approved	562	10,676	38,342	25,633	0.28	68
Implementation phase	66	2,438	1,560	132	1.56	24
Operational	42	1,124	505	23	2.22	12
Trade						
Approved	278	1,782	14,229	3,333	0.13	51
Implementation phase	38	433	3,254	20	0.13	86
Operational	50	260	1,878	995	0.14	38
Hotel and tourism						
Approved	468	2,542	21,338	1,889	0.12	46
Implementation phase	90	559	4,912	94	0.11	55
Operational	113	1,485	3,292	510	0.45	29
Transport and storage, and communication						
Approved	72	4,114	9,424	83	0.44	131
Implementation phase	4	2,225	2,276	5	0.98	569
Operational	17	964	5,168	40	0.19	304
Education						
Approved	483	5,301	29,081	749	0.18	60
Implementation phase	41	525	3,619	0	0.15	88
Operational	73	1,060	3,226	101	0.33	44
Health						
Approved	269	3,307	17,433	165	0.19	65
Implementation phase	61	716	4,852	0	0.15	80
Operational	38	192	1,393	495	0.14	37
Other						
Approved	203	1,085	7,679	1,698	0.14	38
Implementation phase	21	333	739	150	0.45	35
Operational	19	34	352	0	0.10	19
Total						
Approved	9,201	99,645	582,021	516,698	0.17	63
Implementation phase	1,265	24,364	100,239	21,922	0.24	79
Operational	2,226	19,487	94,797	376,301	0.21	43
Memorandum items:	(In percent of approved projects)					
Projects in implementation phase	14	24	17	4	...	...
Projects in operation	24	20	16	73	...	...

Source: Ethiopian Investment Authority.

1/ Excludes projects with initial investment of less than Br 250,000.

2/ As stated in the project application; in millions of birr.

3/ Capital - labor ratio and average employment per project are calculated using permanent employment.

Table 7. Ethiopia: Prices of Petroleum Products, July 2001-December 2003 1/2/
(In birr per liter, unless otherwise indicated)

	Regular Gasoline	Gas Oil (Diesel)	Fuel Oil	Lighting Kerosene
July - November 2001				
Import price	1.32	1.53	1.10	1.55
Addis Ababa	4.30	2.62	2.23	2.00
(in percentage change)	6.44	0.00	0.00	11.11
(in U.S. dollars per kilogram)	0.50	0.31	0.26	0.23
December 2001 - March 2002				
Import price	1.12	1.32	1.22	1.39
Addis Ababa	4.30	2.62	2.23	2.00
(in percentage change)	0.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.50	0.31	0.26	0.23
April - June 2002				
Import price	1.51	1.67	1.54	1.64
Addis Ababa	4.30	2.62	2.23	2.00
(in percentage change)	0.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.50	0.31	0.26	0.23
July - September 2002				
Import price	1.78	1.76	1.65	1.79
Addis Ababa	4.30	2.62	2.23	2.00
(in percentage change)	0.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.50	0.31	0.26	0.23
October 2002 - January 2003				
Import price	1.74	1.84	1.61	1.87
Addis Ababa	4.40	2.72	2.30	2.00
(in percentage change)	2.33	3.82	3.14	0.00
(in U.S. dollars per kilogram)	0.51	0.32	0.27	0.23
February - May 2003				
Import price	1.76	1.89	1.76	2.05
Addis Ababa	4.40	2.72	2.30	2.00
(in percentage change)	0.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.51	0.32	0.27	0.23
June - October 2003				
Import price	1.71	1.73	1.65	1.84
Addis Ababa	4.40	2.72	2.30	2.00
(in percentage change)	0.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.51	0.32	0.27	0.23
November - December 2003				
Import price	1.59	1.97	1.60	2.06
Addis Ababa	4.18	2.72	2.30	2.00
(in percentage change)	-5.00	0.00	0.00	0.00
(in U.S. dollars per kilogram)	0.49	0.32	0.27	0.23

Sources: Ethiopian Petroleum Corporation; and Ministry of Trade and Industry.

1/ Retail prices vary, depending on transportation costs.

2/ As of August 1997, the Ethiopian Petroleum Corporation ceased refining crude petroleum.

Table 8. Ethiopia: Consumer Price Index, January 2002-May 2004

		National			Addis Ababa		
		Overall	Food	Nonfood	General	Food	Nonfood
(December 2000=100)							
2002	March	94.9	90.7	101.2	95.3	91.7	100.7
	June	97.4	95.5	100.3	95.3	90.9	101.9
	September	106.0	108.8	101.8	98.4	97.6	99.6
	December	109.1	113.6	102.3	98.9	97.9	100.4
2003	March	114.3	121.4	103.6	100.9	103.7	96.7
	June	120.3	131.2	103.9	104.4	109.8	96.3
	September	123.6	136.2	104.6	105.9	113.2	95.0
	December	116.1	123.1	105.6	104.1	106.2	101.0
2004	January	114.9	119.8	107.5	103.6	104.6	102.1
	February	116.2	121.2	108.7	104.6	105.3	103.6
	March	118.7	124.7	109.7	104.7	108.0	99.8
	April	122.3	130.4	110.1	107.2	110.6	102.1
	May	122.6	131.3	109.5	107.4	111.1	101.9
(Annual percentage change; end of period)							
2002	March	-6.0	-11.2	2.0	-4.5	-7.8	0.4
	June	-1.0	-1.7	0.0	-2.1	-4.6	1.6
	September	8.6	15.6	-1.0	2.6	4.8	-0.5
	December	14.0	22.8	1.8	2.8	4.7	0.1
2003	March	20.4	33.8	2.4	5.9	13.1	-4.0
	June	23.5	37.4	3.6	9.5	20.8	-5.5
	September	16.6	25.2	2.8	7.6	16.0	-4.6
	December	6.4	8.4	3.2	5.3	8.5	0.6
2004	January	3.0	2.0	4.5	3.3	3.1	3.7
	February	3.3	2.2	5.2	3.5	2.4	5.1
	March	3.8	2.7	5.8	3.8	4.1	3.2
	April	5.1	4.4	6.3	4.0	2.9	5.8
	May	4.8	4.3	5.7	4.0	2.9	5.9
(Annual percentage change; annual average)							
2002	March	-9.2	-16.0	2.5	-6.4	-12.6	4.0
	June	-7.2	-12.7	1.6	-5.5	-10.9	2.9
	September	-2.6	-4.9	1.0	-3.0	-6.1	1.8
	December	1.7	2.6	0.3	-0.8	-2.2	1.2
2003	March	8.4	14.0	0.5	1.5	2.5	0.0
	June	15.1	24.8	1.6	4.6	9.6	-2.2
	September	18.2	29.4	2.3	6.5	13.5	-3.3
	December	17.8	27.7	3.1	7.4	15.3	-3.6
2004	January	16.5	25.1	3.3	7.3	14.7	-3.1
	February	15.1	22.5	3.6	7.1	13.8	-2.4
	March	13.7	19.8	3.9	7.0	13.0	-1.8
	April	12.1	17.2	4.0	6.5	11.5	-0.8
	May	10.7	14.6	4.2	6.1	10.0	0.2
(Monthly percentage change)							
2002	March	0.5	0.7	0.3	-0.8	-0.5	-1.2
	June	2.4	3.8	0.5	1.3	1.9	0.4
	September	2.2	3.7	-0.1	1.4	2.4	0.1
	December	1.0	1.2	0.8	0.6	-0.1	1.7
2003	March	1.6	2.4	0.3	-0.2	0.9	-1.9
	June	2.8	4.2	0.3	1.1	1.7	0.1
	September	-0.2	-0.4	0.2	0.7	1.9	-1.5
	December	-2.4	-4.5	1.4	-0.7	-3.8	4.8
2004	January	-1.0	-2.7	1.9	-0.5	-1.5	1.1
	February	1.1	1.2	1.1	1.0	0.7	1.5
	March	2.2	2.9	0.9	0.1	2.6	-3.7
	April	3.0	4.6	0.4	2.4	2.4	2.3
	May	0.2	0.7	-0.5	0.2	0.5	-0.2

Source: Central Statistical Authority.

Table 9. Ethiopia: Summary of General Government Finances, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr)					
Total revenue and grants	10,387	11,222	12,805	12,834	15,702
Revenue	8,773	9,498	10,177	10,409	11,149
Tax revenue	5,537	6,482	7,440	7,926	8,244
Nontax revenue	3,236	3,016	2,737	2,483	2,906
Grants	1,614	1,724	2,628	2,425	4,553
Total expenditure and net lending (cash basis)	15,454	17,184	15,786	17,651	20,495
Current expenditure	10,528	13,742	10,379	10,550	13,527
Capital expenditure	4,926	3,442	5,003	6,130	6,313
Net lending	0	0	0	0	0
Special programs	0	0	404	971	655
Overall balance (cash basis)					
Including grants	-5,067	-5,961	-2,981	-4,818	-5,526
Excluding grants	-6,681	-7,685	-5,609	-7,243	-10,079
Financing (net)	5,067	5,961	2,981	4,818	5,526
External (net)	1,823	868	2,070	4,905	3,865
Gross borrowing	2,257	1,366	2,686	5,172	3,608
Amortization paid	-434	-498	-616	-696	-557
Domestic (net)	1,515	4,975	57	-87	1,661
Banking system	885	5,499	-213	723	1,651
Nonbanks	629	-524	270	-414	2
Privatization receipts	800	650	400	68	8
Statistical discrepancy/check float	929	-532	454	-464	-733
(In percent of GDP)					
Total revenue and grants	21.3	21.1	23.6	24.7	27.5
Revenue	18.0	17.9	18.8	20.0	19.5
Tax revenue	11.3	12.2	13.7	15.3	14.4
Nontax revenue	6.6	5.7	5.0	4.8	5.1
Grants	3.3	3.2	4.8	4.7	8.0
Total expenditure and net lending (cash basis)	31.7	32.3	29.1	34.0	35.9
Current expenditure	21.6	25.8	19.1	20.3	23.7
Capital expenditure	10.1	6.5	9.2	11.8	11.1
Net lending	0.0	0.0	0.0	0.0	0.0
Special programs	0.0	0.0	0.7	1.9	1.1
Overall balance (cash basis)					
Including grants	-10.4	-11.2	-5.5	-9.3	-9.7
Excluding grants	-13.7	-14.4	-10.3	-13.9	-17.7
Financing (net)	10.4	11.2	5.5	9.3	9.7
External (net)	3.7	1.6	3.8	9.4	6.8
Domestic (net)	3.1	9.4	0.1	-0.2	2.9
Banking system	1.8	10.3	-0.4	1.4	2.9
Nonbanks	1.3	-1.0	0.5	-0.8	0.0
Privatization receipts	1.6	1.2	0.7	0.1	0.0
Statistical discrepancy/check float	1.9	-1.0	0.8	-0.9	-1.3

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

Table 10. Ethiopia: General Government Revenues and Grants, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of birr)				
Tax revenue	5,537	6,482	7,440	7,926	8,244
Direct taxes	2,017	2,367	2,734	3,120	3,010
Income and profit tax	1,842	2,169	2,495	2,979	2,878
Personal income	515	594	686	760	833
Rental income	35	51	48	46	52
Business profits	1,155	1,358	1,457	1,679	1,639
Agricultural income	113	118	121	130	72
Withholding income tax on imports	0	0	125	304	228
Other income	0	0	0	21	24
Interest income	4	6	7	20	21
Capital gains tax	20	42	50	20	10
Rural land use fee	108	111	117	113	89
Urban land lease fee	67	87	123	28	44
Indirect taxes	3,519	4,116	4,706	4,806	5,233
Domestic production, sales, and excise taxes	1,210	1,440	1,381	1,498	1,668
Sales and excise taxes	929	1,087	975	1,060	1,144
Petroleum products 2/	0	0	0	0	0
Alcohol and tobacco	327	259	246	293	278
Other goods	602	828	729	767	866
Services	175	233	282	335	397
Stamp duties	106	120	125	104	127
Import duties	2,156	2,528	3,231	3,280	3,564
Customs duties	1,083	1,126	1,275	1,465	1,606
Sales and other taxes	1,073	1,150	1,434	1,721	1,888
Petroleum products	68	87	107	...	...
Alcohol and tobacco	20	26	31	...	...
Other imports	985	1,037	1,297	...	...
Surtax	0	252	521	94	70
Export taxes	154	148	93	28	1
Nontax revenue	3,236	3,016	2,737	2,483	2,906
Charges and fees	146	200	179	237	212
Sales of goods and services	369	357	340	338	190
Surplus, capital charges, interest payments, and state dividends	1,424	1,183	1,353	1,017	1,403
Pension contributions	--	--	--	--	--
Reimbursement and property sales	65	475	203	288	204
Fines and miscellaneous	768	524	593	521	478
Other extraordinary 3/	464	277	70	81	419
Total revenue	8,773	9,498	10,177	10,409	11,149
External grants	1,614	1,724	2,628	2,425	4,553
Grants in kind/earmarked	1,199	1,694	1,651	1,006	4,086
Untied cash and counterpart funds/grants	415	30	977	1,419	467
Total revenue and grants	10,387	11,222	12,805	12,834	15,702
	(In percent of total revenue)				
Tax revenue	63.1	68.2	73.1	76.1	73.9
Direct taxes	23.0	24.9	26.9	30.0	27.0
Indirect taxes	40.1	43.3	46.2	46.2	46.9
Nontax revenue	36.9	31.8	26.9	23.9	26.1
	(In percent of GDP)				
Tax revenue	11.3	12.2	13.7	15.3	14.4
Direct taxes	4.1	4.4	5.0	6.0	5.3
Income and profit tax	3.8	4.1	4.6	5.7	5.0
Land use fees	0.2	0.2	0.2	0.2	0.2
Indirect taxes	7.2	7.7	8.7	9.3	9.2
Domestic production, sales, and excise taxes	2.5	2.7	2.5	2.9	2.9
Import duties	4.4	4.8	6.0	6.3	6.2
Export taxes	0.3	0.3	0.2	0.1	0.0
Nontax revenue	6.6	5.7	5.0	4.8	5.1
Surplus, capital charges, interest payments, and state dividends	2.9	2.2	2.5	2.0	2.5
Other nontax revenue	3.7	3.4	2.6	2.8	2.6
Grants	3.3	3.2	4.8	4.7	8.0

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

2/ Levied on petroleum refined in Ethiopia; petroleum refining ceased in August 1997.

3/ Data for 1996/97 include sugar auction sales only.

Table 11. Ethiopia: General Government Current Expenditures by Economic Classification, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of birr)				
Wages and operating expenses	7,996	10,690	7,460	7,905	8,755
Wages and salaries	2,812	3,284	3,597	3,789	4,001
Materials	5,184	7,406	3,863	4,116	4,753
Grants and contributions	315	439	533	337	410
Subsidies	0	0	0	0	0
Pensions	232	285	328	297	254
Interest and charges	1,003	1,211	1,080	1,005	1,219
Domestic debt	629	832	575	572	625
External debt	373	379	505	433	594
External assistance	982	1,081	978	1,006	2,890
Safety net measures	6	0	0	0	0
Total current expenditure	10,533	13,707	10,379	10,550	13,527
	(In percent of total current expenditure)				
Wages and operating expenses	75.9	78.0	71.9	74.9	64.7
Wages and salaries	26.7	24.0	34.7	35.9	29.6
Materials	49.2	54.0	37.2	39.0	35.1
Grants and contributions	3.0	3.2	5.1	3.2	3.0
Subsidies	0.0	0.0	0.0	0.0	0.0
Pensions	2.2	2.1	3.2	2.8	1.9
Interest and charges	9.5	8.8	10.4	9.5	9.0
External assistance	9.3	7.9	9.4	9.5	21.4
Safety net measures	0.1	0.0	0.0	0.0	0.0
	(In percent of GDP)				
Wages and operating expenses	16.4	20.1	13.8	15.2	15.3
Wages and salaries	5.8	6.2	6.6	7.3	7.0
Materials	10.6	13.9	7.1	7.9	8.3
Grants and contributions	0.6	0.8	1.0	0.6	0.7
Subsidies	0.0	0.0	0.0	0.0	0.0
Pensions	0.5	0.5	0.6	0.6	0.4
Interest and charges	2.1	2.3	2.0	1.9	2.1
External assistance	2.0	2.0	1.8	1.9	5.1
Safety net measures	0.0	0.0	0.0	0.0	0.0
Total current expenditure	21.6	25.8	19.1	20.3	23.7

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

Table 12. Ethiopia: General Government Expenditures by Functional Classification, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of birr)				
Current expenditure	10,528	13,742	10,379	10,550	13,527
General services	5,716	8,322	5,071	4,630	4,679
Defense	4,336	6,842	3,307	2,610	2,341
Public order and security	382	398	508	574	792
General services 2/	998	1,082	1,256	775	816
Economic services	801	808	943	1,049	1,223
Agriculture and natural resources	538	530	636	675	730
Trade and industry	41	45	55	116	213
Mines and energy	29	30	27	32	39
Tourism	7	10	11	13	22
Transport and communications	74	71	86	63	50
Urban development and construction	74	94	99	119	139
Economic development studies	37	27	30	30	30
Social services	1,918	2,103	2,234	2,800	3,183
Education	1,249	1,305	1,513	1,777	2,276
Culture and sport	27	26	32	57	52
Health	467	395	470	522	526
Labor and social welfare	55	53	61	64	61
Relief and rehabilitation	119	323	158	381	268
Pension payments	0	0	0	0	0
Interest and charges	1,002	1,122	1,080	1,005	1,219
External assistance 3/	974	1,289	978	1,006	2,890
Miscellaneous	112	97	73	61	230
Capital expenditure 4/	4,926	3,442	5,003	6,130	6,313
Economic development	3,004	2,064	3,163	3,330	3,342
Agriculture	688	501	499	793	763
Natural resources	449	252	502	300	300
Mining and energy	420	265	369	375	526
Industry	38	54	36	5	33
Trade and tourism	0	0	2	3	8
Transport construction	1,186	797	1,474	1,527	1,572
Transport and communications	223	196	281	329	141
Financial agencies	0	0	0	0	0
Social development	1,031	626	1,069	994	1,331
Education	479	341	609	540	793
Public health	223	140	313	273	298
Urban development and housing	227	125	131	163	210
General services and compensation	463	366	510	693	444
External assistance 5/	531	405	673	1,113	1,196
Total expenditure	15,455	17,184	15,382	16,681	19,840
	(In percent of total expenditure)				
Current expenditure	68.1	80.0	67.5	63.2	68.2
General services 2/	37.0	48.4	33.0	27.8	23.6
Of which: defense	28.1	39.8	21.5	15.6	11.8
Economic services	5.2	4.7	6.1	6.3	6.2
Social services	12.4	12.2	14.5	16.8	16.0
Interest and charges	6.5	6.5	7.0	6.0	6.1
Other	6.3	7.1	7.1	7.1	7.1
Capital expenditure 4/	31.9	20.0	32.5	36.8	31.8
Economic development	19.4	12.0	20.6	20.0	16.8
Social development	6.7	3.6	7.0	6.0	6.7
General services and compensation	3.0	2.1	3.3	4.2	2.2
External assistance 5/	3.4	2.4	4.4	6.7	6.0
Total social spending (current and capital)	34.6	25.3	39.8	39.1	37.3
Education	11.2	9.6	13.8	13.9	15.5
Health	4.5	3.1	5.1	4.8	4.2
Other	19.0	12.6	20.9	20.5	17.7
	(In percent of GDP)				
Current expenditure	21.6	25.8	19.1	20.3	23.7
General services 2/	11.7	15.6	9.4	8.9	8.2
Of which: defense	8.9	12.9	6.1	5.0	4.1
Economic services	1.6	1.5	1.7	2.0	2.1
Social services	3.9	4.0	4.1	5.4	5.6
Interest and charges	2.1	2.1	2.0	1.9	2.1
Other	2.2	2.6	1.9	2.1	5.6
Capital expenditure 4/	10.1	6.5	9.2	11.8	11.1
Economic development	6.2	3.9	5.8	6.4	5.9
Social development	2.1	1.2	2.0	1.9	2.3
General services and compensation	0.9	0.7	0.9	1.3	0.8
External assistance 5/	0.0	0.0	0.0	0.0	0.0
Total social spending (current and capital)	11.0	8.2	11.3	12.6	13.0
Education	3.5	3.1	3.9	4.5	5.4
Health	1.4	1.0	1.4	1.5	1.4
Other 6/	6.0	4.1	5.9	6.6	6.1

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

2/ Includes organs of state and judiciary.

3/ Imputed value of goods and services provided through external grants, mainly aid in kind.

4/ Includes outlays other than investment proper, such as operating expenses of certain development agencies.

5/ Details across sectors unavailable. However, the 2003/04 estimate for external assistance is incorporated in sector estimates.

6/ Includes culture and sports, labor and social welfare, relief and rehabilitation, and urban development and housing.

Table 13. Ethiopia: Summary of Regional Government Finances, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of birr)				
Total revenue 2/	1,540	1,768	1,823	1,964	2,105
Tax revenue	1,079	1,248	1,388	1,453	1,565
Income and profits tax	701	777	903	1,062	1,197
Land use fees	176	198	239	140	132
Domestic sales and excise taxes	152	197	179	192	161
Stamp duties	51	76	67	58	75
Nontax revenue	460	520	435	511	540
Total expenditure	4,517	4,244	5,146	5,438	6,225
Current expenditure	3,028	3,039	3,500	3,906	4,755
General services	954	966	1,082	1,180	1,418
Economic services	536	550	637	688	770
Social services	1,499	1,498	1,731	1,995	2,396
Pension payments	22	25	0	0	0
Miscellaneous	17	0	51	44	171
Capital expenditure	1,489	1,205	1,646	1,532	1,470
Economic development	891	776	913	889	791
Social development	371	270	567	430	483
General development	226	158	165	213	196
Overall balance 3/	-2,977	-2,475	-3,323	-3,474	-4,120
	(In percent of GDP)				
Total revenue 2/	3.2	3.3	3.4	3.8	3.7
Tax revenue	2.2	2.3	2.6	2.8	2.7
Nontax revenue	0.9	1.0	0.8	1.0	0.9
Total expenditure	9.3	8.0	9.5	10.5	10.9
Current expenditure	6.2	5.7	6.5	7.5	8.3
<i>Of which</i>					
Social services	3.1	2.8	3.2	3.8	4.2
Capital expenditure	3.1	2.3	3.0	2.9	2.6
<i>Of which</i>					
Social development	0.8	0.5	1.0	0.8	0.8
Overall balance 3/	-6.1	-4.7	-6.1	-6.7	-7.2
	(In percent of general government total)				
Total revenue 2/	14.8	15.8	14.2	15.3	13.4
Tax revenue	19.5	19.3	18.7	18.3	19.0
Nontax revenue	14.2	17.2	15.9	20.6	18.6
Total expenditure	29.2	24.7	32.6	30.8	30.4
Current expenditure	28.8	22.1	33.7	37.0	35.2
<i>Of which</i>					
Social services	78.1	71.3	77.5	71.2	75.3
Capital expenditure	30.2	35.0	32.9	25.0	23.3
<i>Of which</i>					
Social development	36.0	43.2	53.1	43.3	36.3

Sources: Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Beginning in 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30.

2/ Revenue from taxes, rents, and fees levied and collected by the regional governments.

3/ Deficit (-) covered by direct transfer from federal government of joint tax receipts and foreign assistance.

Table 14. Ethiopia: Monetary Survey, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr, unless otherwise specified)					
Foreign assets (net)	6,388	4,783	4,861	8,295	11,290
National Bank of Ethiopia	2,374	1,929	1,661	4,225	6,273
Assets	3,527	2,870	2,857	5,692	8,003
Liabilities	1,153	941	1,196	1,467	1,731
Commercial banks	4,014	2,854	3,200	4,070	5,018
Assets	5,735	4,957	5,125	5,729	6,731
Liabilities	1,722	2,104	1,925	1,659	1,713
Domestic credit	20,577	27,114	27,764	27,617	28,332
Claims on government (net)	10,258	15,757	15,544	16,268	17,855
National Bank of Ethiopia	8,275	14,000	9,850	9,006	9,804
Commercial banks	1,982	1,757	5,695	7,262	8,052
Claims on nongovernment	10,320	11,357	12,220	11,349	10,477
National Bank of Ethiopia	465	394	394	394	114
Commercial banks	9,855	10,963	11,826	10,955	10,364
Other items (net)	-7,260	-9,440	-8,024	-8,290	-9,117
National Bank of Ethiopia	-3,839	-4,978	-3,419	-3,646	-3,526
Commercial banks	-3,422	-4,462	-4,606	-4,644	-5,591
Broad money	19,704	22,456	24,598	27,622	30,506
Money	11,658	13,265	13,778	15,457	16,815
Currency outside banks	5,220	5,923	5,930	6,536	7,726
Demand deposits	6,438	7,343	7,848	8,921	9,089
Quasi-money	8,047	9,191	10,820	12,166	13,691
Savings deposits	7,204	8,356	9,824	11,071	12,529
Time deposits	843	835	996	1,094	1,162
(Annual percentage change with respect to beginning-period broad money)					
Foreign assets (net)	3.6	-8.1	0.3	14.0	10.8
Domestic credit	8.8	33.2	2.9	-0.6	2.6
Claims on government (net)	4.8	27.9	-0.9	2.9	5.7
Claims on nongovernment	4.1	5.3	3.8	-3.5	-3.2
Broad money	5.9	14.0	9.5	12.3	10.4
Money	3.7	8.2	2.3	6.8	4.9
Quasi money	2.1	5.8	7.3	5.5	5.5
(In millions of birr, unless otherwise specified)					
Memorandum items:					
Net domestic assets	13,317	17,674	19,740	19,327	19,216
Reserve money	7,276	11,346	8,487	9,979	12,664
Excess reserves (in percent of deposits)	6.3	24.5	5.3	8.1	12.8
Quasi money / broad money (in percent)	40.8	40.9	44.0	44.0	44.9
Velocity (GDP / broad money)	2.5	2.4	2.2	1.9	1.9

Source: Ethiopian authorities.

1/ Year ending July 7.

Table 15. Ethiopia: Loan Portfolio of the Banking System, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr)					
Claims on the government (net)	10,258	15,757	15,544	16,268	17,855
Development Bank of Ethiopia advances	465	394	394	394	114
Nongovernment	11,360	12,673	13,518	13,278	13,118
Nonfinancial public enterprises 3/	1,025	782	1,081	1,099	785
Financial public enterprises 4/	555	680	557	505	449
Cooperatives	396	397	312	317	314
Private sector	9,384	10,814	11,568	11,358	11,570
Total	22,082	28,824	29,457	29,940	31,087
(In percent of total)					
Claims on the government (net)	46.5	54.7	52.8	54.3	57.4
Development Bank of Ethiopia advances	2.1	1.4	1.3	1.3	0.4
Nongovernment	51.4	44.0	45.9	44.3	42.2
Nonfinancial public enterprises 3/	4.6	2.7	3.7	3.7	2.5
Financial public enterprises 4/	2.5	2.4	1.9	1.7	1.4
Cooperatives	1.8	1.4	1.1	1.1	1.0
Private sector	42.5	37.5	39.3	37.9	37.2
(Percentage change with respect to total net claims of the banking system at beginning of the fiscal year)					
Claims on the government (net)	4.4	24.9	-0.7	2.5	5.3
Development Bank of Ethiopia advances	0.0	-0.3	0.0	0.0	-0.9
Nongovernment	5.0	5.9	2.9	-0.8	-0.5
Nonfinancial public enterprises 3/	-3.6	-1.1	1.0	0.1	-1.0
Financial public enterprises 4/	0.3	0.6	-0.4	-0.2	-0.2
Cooperatives	0.7	0.0	-0.3	0.0	0.0
Private sector	7.6	6.5	2.6	-0.7	0.7
Total	9.4	30.5	2.2	1.6	3.8

Source: Ethiopian authorities.

1/ Year ending July 7.

2/ Includes provision for doubtful loans and loans to public banks, except the Development Bank of Ethiopia.

3/ Excludes equity investment.

4/ Excludes deposit claims on specialized banks.

Table 16. Ethiopia: Sectoral Breakdown of Commercial Bank Claims on Nongovernment Sectors, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr)					
Agriculture	418.4	432.5	422.5	502.7	463.8
Manufacturing	954.3	996.1	1,359.1	1,476.4	1,688.5
Large-scale industry	...	...	...	...	...
Small-scale industry	...	...	...	...	...
Exports	1,179.5	1,032.4	1,079.6	881.8	856.3
Coffee	...	...	...	...	...
Noncoffee	...	...	...	...	...
Imports	2,064.8	2,125.4	1,227.7	2,148.6	1,702.9
Construction	1,431.0	1,458.8	1,552.7	1,492.2	1,723.8
Domestic trade and services	3,213.8	3,660.6	3,786.1	3,389.3	3,232.5
Domestic trade	1,908.4	2,267.2	2,199.8	1,861.1	1,947.8
Transport	635.2	918.6	939.7	785.1	583.6
Hotel and tourism	154.8	140.8	142.0	198.4	116.9
Other services	515.4	334.0	504.6	544.7	584.2
Personal	19.3	22.6	26.1	29.2	55.2
Others	2,273.6	3,083.5	3,326.2	3,583.9	3,717.1
Total reported	11,554.7	12,811.9	12,780.0	13,504.1	13,440.1
(In percent of total)					
Agriculture	3.6	3.4	3.3	3.7	3.5
Manufacturing	8.3	7.8	10.6	10.9	12.6
Large-scale industry	...	...	...	...	...
Small-scale industry	...	...	...	...	...
Exports	10.2	8.1	8.4	6.5	6.4
Coffee	...	...	...	...	...
Noncoffee	...	...	...	...	...
Imports	17.9	16.6	9.6	15.9	12.7
Construction	12.4	11.4	12.1	11.0	12.8
Domestic trade and services	27.8	28.6	29.6	25.1	24.1
Domestic trade	16.5	17.7	17.2	13.8	14.5
Transport	5.5	7.2	7.4	5.8	4.3
Hotel and tourism	1.3	1.1	1.1	1.5	0.9
Other services	4.5	2.6	3.9	4.0	4.3
Personal	0.2	0.2	0.2	0.2	0.4
Others	19.7	24.1	26.0	26.5	27.7

Source: Ethiopian authorities.

1/ Data for each year pertain to June 30.

2/ Includes provision for doubtful loans and loans to public banks, except the Development Bank of Ethiopia.

Table 17. Ethiopia: Commercial Bank Lending and Deposits, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
Lending					
(In millions of birr)					
Central government	2,764	2,632	6,961	8,513	10,275
Other sectors	11,360	12,673	13,518	13,278	13,118
Nonfinancial public enterprises 3/	1,025	782	1,081	1,099	785
Financial public enterprises 4/	555	680	557	505	449
Cooperatives	396	397	312	317	314
Private sector	9,384	10,814	11,568	11,358	11,570
Total lending	14,124	15,305	20,479	21,791	23,393
(In percent of total lending)					
Central government	19.6	17.2	34.0	39.1	43.9
Other sectors	80.4	82.8	66.0	60.9	56.1
Nonfinancial public enterprises 3/	7.3	5.1	5.3	5.0	3.4
Financial public enterprises 4/	3.9	4.4	2.7	2.3	1.9
Cooperatives	2.8	2.6	1.5	1.5	1.3
Private sector	66.4	70.7	56.5	52.1	49.5
Deposits					
(In millions of birr)					
Demand deposits	9,084	10,525	11,174	12,124	13,396
Public enterprises	2,947	3,595	3,634	4,111	3,621
Cooperatives	366	381	375	393	432
Private sector	2,741	2,900	3,384	3,773	4,392
Central government	775	867	1,259	1,244	2,215
Other 5/	2,255	2,783	2,523	2,603	2,737
Savings deposits	7,204	8,356	9,824	11,071	12,529
Public enterprises	27	201	34	34	38
Cooperatives	110	128	160	190	206
Private sector	7,035	7,979	9,585	10,788	12,199
Other 5/	32	48	46	59	86
Time deposits	850	842	1,003	1,102	1,170
Public enterprises	109	72	116	90	80
Cooperatives	31	30	13	24	32
Private sector	255	361	417	504	556
Central government	8	8	8	8	8
Others 5/	447	371	450	477	494
Total deposits	17,138	19,724	22,002	24,298	27,095
(In percent of deposits)					
Demand deposits	53.0	53.4	50.8	49.9	49.4
Savings deposits	42.0	42.4	44.7	45.6	46.2
Time deposits	5.0	4.3	4.6	4.5	4.3

Source: Ethiopian authorities.

1/ Year ending July 7.

2/ Includes provision for doubtful loans and loans to public banks, except the Development Bank of Ethiopia.

3/ Excludes equity investment.

4/ Excludes deposit claims on specialized banks.

5/ Includes domestic financial agencies and nontransferable accounts of nonresidents.

Table 18. Ethiopia: Reserve and Liquidity Position of Commercial Banks, 1998/99-2002/03
(In millions of birr, unless otherwise indicated)

	1998/99	1999/2000	2000/01	2001/02	2002/03
Reserve requirement					
Net deposits 2/	16,017	18,482	21,635	23,277	26,406
Reserve requirement 3/	801	924	1,082	1,164	1,320
Actual reserves	2,414	4,404	2,500	2,696	3,817
Excess reserves	1,613	3,480	1,418	1,532	2,497
Actual reserve ratio (in percent)	15.1	23.8	11.6	11.6	14.5
Liquidity requirement					
Net current deposits 4/	15,157	17,677	20,639	22,173	25,258
Liquidity requirement 5/	2,273	2,652	3,096	3,326	3,789
Actual liquidity assets	7,601	9,680	6,840	9,575	16,461
Excess liquidity	5,327	7,028	3,744	6,249	12,672
Actual liquidity ratio (in percent)	50.1	54.8	33.1	43.2	65.2

Source: Ethiopian authorities.

1/ Data for each year pertain to June 30.

2/ Demand, savings, and time deposits, less uncleared checks paid, and less uncleared effects (foreign).

3/ Five percent of net deposits.

4/ Net deposits, less deposits at notice (deposits that can be withdrawn after 30 days' notice).

5/ Fifteen percent of net current deposits.

Table 19. Ethiopia: Structure of Interest Rates, 1998/99-2002/03 1/
(In percent per annum)

	1998/99	1999/2000	2000/01				2001/02				2002/03			
	Jun.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
Deposit rates														
Savings deposits 2/	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	3.5	3.0	3.0	3.0	3.0	3.0
Time deposits 3/														
30 days' notice	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	3.0	3.3	3.3	3.3	3.4	3.4
3 months to less than 6 months	6.1	6.1	6.2	6.2	6.2	6.2	6.2	6.2	4.1	3.3	3.4	3.4	3.5	3.5
6 months to less than 12 months	6.3	6.3	6.3	6.3	6.3	6.4	6.4	6.4	4.2	3.4	3.5	3.6	3.6	3.6
1 year to less than 2 years	6.4	6.3	6.5	6.5	6.5	6.6	6.6	6.6	4.4	3.5	3.4	3.7	3.7	3.7
2 years and above	6.4	6.5	6.9	6.9	6.7	6.7	6.8	6.8	4.5	3.6	3.7	3.7	3.8	3.8
Lending rates														
Bank lending rates														
Minimum	10.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5	7.5	7.5	7.5	7.5	7.5	7.5
Maximum	13.0	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.5	13.0	13.0	13.0	13.0	13.0
Treasury bill yield 4/	4.8	2.9	1.9	0.7	3.7	3.0	2.5	1.5	1.5	0.2	0.9	0.8	2.0	1.3

Source: Ethiopian authorities.

1/ Data for end-year pertain to June 30.

2/ Minimum rate.

3/ Weighted rate, Starting March 2002.

4/ 91-day bill, at auction, end-period.

Table 20. Ethiopia: Exchange Rate Developments, 1992/93-2002/03 1/

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03
	(Period average; 1990 = 100)										
Effective exchange rates											
Nominal	50.3	44.9	41.4	43.0	43.1	43.5	39.6	40.1	42.7	40.1	42.7
Real	60.6	51.7	52.6	48.3	48.8	48.2	48.7	48.1	42.2	48.1	42.2
	(Annual percentage change; - depreciation)										
Nominal	-53.1	-10.7	-7.9	3.7	0.2	1.0	-9.1	1.5	6.5	1.5	6.5
Real	-54.9	-14.8	1.9	-8.3	1.1	-1.1	0.9	-1.2	-12.3	-1.2	-12.3
Memorandum items: 2/	(In units indicated)										
Birr per U.S. dollar, end of period	5.10	6.22	6.32	6.35	6.78	7.09	8.12	8.23	8.47	8.23	8.47
Birr per U.S. dollar, period average	3.70	5.81	6.25	6.33	6.50	6.86	7.53	8.15	8.34	8.15	8.34
Birr per SDR, end of period	7.02	8.20	9.80	9.17	9.44	9.40	10.85	11.00	10.54	11.00	10.54
Birr per SDR, period average	5.25	7.14	8.75	9.34	9.21	9.32	10.27	11.04	10.72	11.04	10.72
	(Annual percentage change; - depreciation)										
Birr per U.S. dollar, end of period	-146.4	-22.0	-1.6	-0.5	-6.8	-4.6	-14.6	-1.3	-2.9	-1.3	-2.9
Birr per U.S. dollar, period average	-78.6	-57.0	-7.6	-1.3	-2.7	-5.6	-9.7	-8.2	-2.3	-8.2	-2.3
Birr per SDR, end of period	-136.9	-16.8	-19.6	6.5	-3.0	0.4	-15.4	-1.4	4.2	-1.4	4.2
Birr per SDR, period average	-84.5	-36.1	-22.5	-6.7	1.4	-1.2	-10.3	-7.4	2.9	-7.4	2.9

Sources: Ethiopian authorities; and IMF, *International Financial Statistics*, and Information Notice System.

1/ Beginning 1997/98, data pertain to the period July 8-July 7; prior to that, data pertain to the period July 1-June 30. Effective exchange rates based on July-June averages.

2/ Since May 1993, marginal rates at foreign exchange auctions; since October 2001, rates in the interbank market.

Table 21. Ethiopia: Balance of Payments, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of U.S. dollars)				
Current account balance	-510	-335	-233	-347	-310
(excluding official transfers)	-723	-626	-629	-782	-850
Merchandise trade balance	-1,074	-1,125	-1,094	-1,244	-1,458
Exports	484	486	463	452	483
Coffee	281	262	182	163	165
Other	203	224	281	289	318
Imports	1,558	1,611	1,557	1,696	1,940
Cereals	66	86	78	155	273
Aircraft	2	1	13	11	17
Other	1,490	1,525	1,466	1,529	1,650
Services (net)	114	149	137	153	167
Income (net)	-52	-60	-51	-40	-55
<i>Of which:</i> Official interest payments	-82	-76	-70	-52	-72
Current transfers (net)	502	701	775	783	1,035
Private transfers (net)	289	410	379	349	495
Official transfers (net)	213	291	395	435	540
Capital account balance	37	-31	169	652	472
Investment assets and liabilities (net)	-145	152	258	508	364
Official, medium and long term	-263	-10	194	489	353
Disbursements	212	182	320	574	443
Amortization	474	191	126	86	90
Other public long term (net) 2/	-18	-20	-14	19	-4
Long-term private (net, including foreign direct investment)	136	51	52	0	14
Short-term public and private (net)	0	130	26	0	0
Errors and omissions (net)	182	-183	-89	144	108
Overall balance	-473	-366	-64	305	161
Financing	473	366	64	-305	-161
Change in net foreign assets (increase -)	21	225	7	-394	-344
Central bank	-15	44	38	-297	-236
Reserves (increase -)	-23	63	11	-327	-266
Liabilities	8	-19	27	30	30
Commercial banks	36	181	-31	-97	-108
Change in arrears	122	40	-810	0	0
Debt relief 3/	330	101	867	89	183
	(In percent of GDP, unless otherwise indicated)				
Current account balance	-7.9	-5.1	-3.6	-5.7	-4.7
(excluding official transfers)	-11.2	-9.6	-9.7	-12.9	-12.8
Merchandise trade balance	-16.6	-17.2	-16.8	-20.5	-21.9
Exports	7.5	7.4	7.1	7.4	7.3
Imports	24.1	24.7	23.9	27.9	29.2
(excluding external cereals/aid in kind)	23.1	23.4	22.7	25.3	25.1
Capital account balance	0.6	-0.5	2.6	10.7	7.1
Overall balance	-7.3	-5.6	-1.0	5.0	2.4
Memorandum item:					
GDP (in millions of U.S.dollars)	6,469	6,525	6,503	6,079	6,652

Sources: National Bank of Ethiopia; Ministry of Finance and Economic Development; and Fund staff estimates.

1/ Data for the period July 8-July 7.

2/ Ethiopian Airlines and other public enterprises.

3/ Includes a Paris Club rescheduling agreement in 1997/98.

Table 22. Ethiopia: Exports, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(Value in millions of U.S. dollars; volume in thousands of metric tons; and price in U.S. dollars per thousand metric tons)					
Coffee	281.2	262.0	182.0	163.2	165.191
Volume	101.2	116.6	95.6	110.3	126.1
Price	2.78	2.25	1.90	1.48	1.31
Pulses	13.5	9.8	8.7	32.9	19.86
Volume	29.8	23.5	25.2	109.2	66.2
Price	0.45	0.42	0.30	0.30	0.3
Oilseeds	36.1	31.4	32.4	32.6	46.48
Volume	51.4	43.1	52.4	76.6	83
Price	0.70	0.73	0.60	0.43	0.56
Sugar and molasses	0.2	2.9	8.0	10.0	17.71
Volume	6.6	17.2	56.4	58.0	77
Price	0.03	0.17	0.14	0.17	0.23
Leather and leather products	32.4	35.2	76.0	55.5	51.975
Volume	5.8	8.6	12.1	10.3	10.5
Price	5.59	4.09	6.30	5.37	4.95
Live animals	0.8	1.7	0.3	0.8	0.474
Volume	0.9	1.8	0.3	0.2	0.6
Price	0.89	0.94	1.10	5.03	0.79
Meat, canned and frozen	4.2	4.0	1.8	1.1	2.397
Volume	2.1	2.0	0.9	0.7	1.7
Price	2.00	2.00	1.98	1.67	1.41
Fruits and vegetables	5.4	5.4	5.3	9.4	9.614
Volume	19.4	20.7	16.1	29.7	25.3
Price	0.28	0.26	0.33	0.32	0.38
Chat	59.2	76.0	61.2	49.0	57.53
Volume	8.7	15.7	11.9	9.4	11
Price	6.80	4.84	5.10	5.23	5.23
Gold	23.2	31.9	28.2	35.0	42.1
Volume	3.1	4.6	4.3	5.0	5
Price	7.48	6.93	6.60	7.04	8.42
Other exports 3/	28.0	25.6	58.8	62.9	69.4
Total exports	484.2	485.9	462.7	452.4	482.7
(excluding coffee)	203.0	223.9	280.7	289.2	317.5
(In percent of GDP)					
Coffee exports	4.3	4.0	2.8	2.7	2.5
Noncoffee exports	3.1	3.4	4.3	4.8	4.8
(In percent of total exports)					
Coffee	58.1	53.9	39.3	36.1	34.2
Pulses	2.8	2.0	1.9	7.3	4.1
Oilseeds	7.5	6.5	7.0	7.2	9.6
Leather and leather products	6.7	7.2	16.4	12.3	10.8
Chat	12.2	15.6	13.2	10.8	11.9
Gold	4.8	6.6	6.1	7.7	8.7
Other	8.0	8.1	16.0	18.6	20.6

Sources: National Bank of Ethiopia; and Fund staff estimates.

1/ Data for the period July 8-July 7.

2/ Data based on customs records, except gold, for which data are reported by the National Bank of Ethiopia.

3/ Includes textiles, essence oils, and spices.

Table 23. Ethiopia: Imports, c.i.f., by End Use, 1998/99-2002/03 1/ 2/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of U.S. dollars)				
Raw materials	27.1	19.8	23.9	29.7	21.8
Semifinished goods	261.8	204.9	284.3	288.3	274.6
Fuel	177.1	250.1	292.6	267.7	287.7
Capital goods	525.2	470.5	444.9	480.1	549.5
Transport	154.4	140.1	153.5	139.9	174.0
<i>Of which:</i> aircraft	2.2	0.5	12.6	11.4	17.3
Agricultural	14.9	10.5	8.1	7.0	5.9
Industrial	356.0	319.9	283.3	333.3	369.6
Consumer goods	437.8	432.0	467.7	587.1	654.3
Durable	153.2	141.1	152.0	153.1	183.6
Nondurable	284.6	290.8	315.7	434.0	470.8
<i>Of which:</i> food	100.4	116.4	109.8	208.4	231.7
Miscellaneous 3/	129.0	233.5	43.4	42.8	68.4
Total imports, c.i.f.	1,558.0	1,610.8	1,556.8	1,695.7	1,856.4
(excluding fuel)	1,380.9	1,360.7	1,264.2	1,428.0	1,568.7
	(In percent of GDP)				
Nonfuel imports	21.3	20.8	19.4	23.6	23.6
Fuel imports	2.7	3.8	4.5	4.4	4.3
	(In percent of total)				
Raw materials	1.7	1.2	1.5	1.8	1.2
Semifinished goods	16.8	12.7	18.3	17.0	14.8
Fuel	11.4	15.5	18.8	15.8	15.5
Capital goods	33.7	29.2	28.6	28.3	29.6
Consumer goods	28.1	26.8	30.0	34.6	35.2
Miscellaneous	8.3	14.5	2.8	2.5	3.7

Sources: National Bank of Ethiopia; and Fund staff estimates.

1/ Data pertain to the period July 8-July 7.

2/ Data based on customs records.

3/ Includes military imports.

Table 24. Ethiopia: Merchandise Trade Unit Values and Volumes, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(Index, 1996/97 = 100)				
Unit value indices					
Imports	91.5	115.2	113.2	111.8	120.4
Exports	90.8	75.6	71.8	63.1	61.2
Terms of trade	99.3	65.6	63.4	56.5	50.8
Volume indices					
Imports	129.5	100.3	97.7	107.6	114.9
Exports	89.3	104.5	104.9	115.1	126.4
	(Annual percentage change)				
Unit value					
Imports	-3.0	25.9	-0.8	-1.2	7.6
Exports	-18.5	-16.7	-5.1	-12.0	-3.1
Terms of trade	-15.9	-33.9	-3.4	-10.9	-10.0
Volume					
Imports	17.8	-22.5	-2.6	10.2	6.8
Exports	-1.1	17.1	0.3	9.8	9.8
Memorandum items:					
Value of imports	14.8	3.4	-3.4	8.9	14.4
Value of exports	-19.6	0.4	-4.8	-2.2	6.7

Sources: National Bank of Ethiopia; and Fund staff estimates.

1/ Data for the period July 8-July 7.

Table 25. Ethiopia: Recorded Imports by Country of Origin, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
	(In millions of birr)				
European Union	3,574	3,652	3,600	4,636	4,295
Belgium and Luxembourg	254	208	285	333	393
France	293	439	386	368	224
Germany	679	636	632	766	691
Italy	906	897	1,000	1,287	1,091
Netherlands	204	273	264	327	424
United Kingdom	542	517	487	584	717
Other	698	682	545	971	755
Eastern Europe	144	163	327	153	298
Russia	30	62	130	51	216
Other	114	102	198	103	82
Other Europe	417	536	355	357	482
Turkey	187	201	149	236	281
Other	230	335	205	120	200
Total Europe	4,135	4,351	4,282	5,146	5,074
Western Hemisphere	698	803	794	1,571	1,192
Canada	28	38	88	92	55
United States	548	743	658	1,392	959
Other	122	22	48	87	177
Asia and Middle East	4,391	5,507	4,559	6,737	7,305
China	455	615	918	1,216	1,481
India	526	418	712	724	891
Japan	591	788	651	513	1,043
Korea	371	303	309	265	242
Saudi Arabia	1,161	226	519	1,970	1,308
Other	1,287	3,156	1,450	2,049	2,342
Africa	763	696	847	899	1,242
Djibouti	289	168	360	387	571
Kenya	133	170	121	138	161
Other	341	358	366	374	511
Australia	73	46	48	44	47
Other (including unspecified)	1,642	1,713	2,438	90	1,069
Total imports, c.i.f.	11,702	13,116	12,968	14,486	15,930
	(In percent of total)				
European Union	30.5	27.8	27.8	32.0	27.0
Belgium and Luxembourg	2.2	1.6	2.2	2.3	2.5
France	2.5	3.3	3.0	2.5	1.4
Germany	5.8	4.8	4.9	5.3	4.3
Italy	7.7	6.8	7.7	8.9	6.9
Netherlands	1.7	2.1	2.0	2.3	2.7
United Kingdom	4.6	3.9	3.8	4.0	4.5
Other	6.0	5.2	4.2	6.7	4.7
Eastern Europe	1.2	1.2	2.5	1.1	1.9
Other Europe	3.6	4.1	2.7	2.5	3.0
Total Europe	35.3	33.2	33.0	35.5	31.9
Western Hemisphere	6.0	6.1	6.1	10.8	7.5
Canada	0.2	0.3	0.7	0.6	0.3
United States	4.7	5.7	5.1	9.6	6.0
Other	1.0	0.2	0.4	0.6	1.1
Asia and Middle East	37.5	42.0	35.2	46.5	45.9
China	3.9	4.7	7.1	8.4	9.3
India	4.5	3.2	5.5	5.0	5.6
Japan	5.0	6.0	5.0	3.5	6.5
Korea	3.2	2.3	2.4	1.8	1.5
Saudi Arabia	9.9	1.7	4.0	13.6	8.2
Other	11.0	24.1	11.2	14.1	14.7
Africa	6.5	5.3	6.5	6.2	7.8
Australia	0.0	0.0	0.0	0.0	0.0
Other (including unspecified)	14.0	13.1	18.8	0.6	6.7

Sources: National Bank of Ethiopia; and Fund staff estimates.

1/ Data pertain to the period July 8-July 7.

Table 26. Ethiopia: Exports by Country of Destination, 1998/99-2002/03 1/

	1998/99	1999/2000	2000/01	2001/02	2002/03
(In millions of birr)					
European Union	1,327.3	1,452.1	1,138.5	1,386.3	1,341.3
Belgium and Luxembourg	123.3	121.0	88.7	118.8	76.6
France	165.4	138.3	95.1	111.3	273.6
Germany	634.6	711.6	396.4	437.9	352.9
Italy	239.9	240.8	322.7	391.9	183.2
Netherlands	52.1	76.0	48.2	55.2	142.0
United Kingdom	83.8	86.7	114.9	139.8	76.7
Other	28.2	77.7	72.5	131.4	236.3
Eastern Europe	36.6	52.1	17.3	29.0	13.6
Russia	0.6	0.9	1.8	0.0	0.4
Other	36.0	51.2	15.5	29.0	13.2
Other Europe	66.8	163.4	306.7	235.5	93.0
Switzerland	32.8	158.9	206.3	235.5	79.8
Other	34.0	4.5	100.4	...	13.2
Total Europe	1,430.7	1,667.6	1,462.5	1,650.8	1,447.9
Western Hemisphere	196.5	200.5	147.0	216.2	356.1
United States	170.2	176.1	124.6	165.9	340.1
Other	26.3	24.4	22.4	50.3	16.0
Asia and Middle East	1,230.9	1,198.4	1,126.2	1,292.5	854.2
China	7.6	6.9	14.7	91.0	22.5
Israel	100.2	122.0	105.9	149.0	201.0
Japan	460.5	429.0	380.9	294.6	188.4
Saudi Arabia	408.4	353.4	295.1	229.5	182.4
Other	254.2	287.1	329.6	528.4	259.8
Africa	629.1	771.9	874.2	411.9	792.1
Djibouti	331.4	405.4	620.1	272.1	289.8
Kenya	2.8	8.4	15.7	0.2	134.3
Other	294.9	358.1	238.4	139.6	367.9
Australia	9.0	8.6	6.4	7.9	4.4
Other (including unspecified)	0.5	111.0	63.7	285.0	687.7
Total exports, f.o.b.	3,496.7	3,958.0	3,680.0	3,864.3	4,142.4
(In percent of total)					
European Union	38.0	36.7	30.9	35.9	32.4
Belgium and Luxembourg	3.5	3.1	2.4	3.1	1.8
France	4.7	3.5	2.6	2.9	6.6
Germany	18.1	18.0	10.8	11.3	8.5
Italy	6.9	6.1	8.8	10.1	4.4
Netherlands	1.5	1.9	1.3	1.4	3.4
United Kingdom	2.4	2.2	3.1	3.6	1.9
Other	0.8	2.0	2.0	3.4	5.7
Eastern Europe	1.0	1.3	0.5	0.7	0.3
Other Europe	1.9	4.1	8.3	6.1	2.2
Total Europe	40.9	42.1	39.7	42.7	35.0
Western Hemisphere	5.6	5.1	4.0	5.6	8.6
United States	4.9	4.4	3.4	4.3	8.2
Other	0.8	0.6	0.6	1.3	0.4
Asia and Middle East	35.2	30.3	30.6	33.4	20.6
China	0.2	0.2	0.4	2.4	0.5
Israel	2.9	3.1	2.9	3.9	4.9
Japan	13.2	10.8	10.4	7.6	4.5
Saudi Arabia	11.7	8.9	8.0	5.9	4.4
Other	7.3	7.3	9.0	13.7	6.3
Africa	18.0	19.5	23.8	10.7	19.1
Australia	0.3	0.2	0.2	0.2	0.1
Other (including unspecified)	0.0	2.8	1.7	7.4	16.6

Sources: National Bank of Ethiopia; and Fund staff estimates.

1/ Includes reexports. Data pertain to the period July 8-July 7.

Table 27. Ethiopia: Public and Publicly Guaranteed External Debt Outstanding, 1998/99-2002/03

	1998/99		1999/2000		2000/01		2001/02		2002/03	
	Debt stock	<i>Of which:</i> arrears	Debt stock	<i>Of which:</i> arrears	Debt stock	<i>Of which:</i> arrears	Debt stock	<i>Of which:</i> arrears	Debt stock	<i>Of which:</i> arrears 1/
(In millions of U.S. dollars)										
Multilateral	2,701	0	2,795	0	2,929	0	3,642	0	4,249	0
IMF	77	0	65	0	89	0	102	0	141	0
IDA	1,665	0	1,747	0	1,892	0	2,438	0	2,939	0
AfDB/AfDF	830	0	838	0	788	0	896	0	922	0
Other	130	0	145	0	160	0	206	0	246	0
Official bilateral	1,318	575	2,482	810	2,442	0	2,485	0	2,492	605
Paris Club	715	86	1,868	207	1,863	0	1,889	0	1,871	0
Other official bilateral	603	489	614	603	579	0	597	0	622	605
Commercial	127	64	116	0	107	0	91	0	104	104
Total	4,146	639	5,393	810	5,478	0	6,218	0	6,845	709
(In percent of GDP)										
Multilateral	41.8	0.0	42.8	0.0	45.0	0.0	59.9	0.0	63.9	0.0
Official bilateral	20.4	8.9	38.0	12.4	37.6	0.0	40.9	0.0	37.5	9.1
Commercial	2.0	1.0	1.8	0.0	1.6	0.0	1.5	0.0	1.6	1.6
Total	64.1	9.9	82.7	12.4	84.2	0.0	102.3	0.0	102.9	10.7
(In percent of total)										
Multilateral	65.1	0.0	51.8	0.0	53.5	...	58.6	...	62.1	0.0
Official bilateral	31.8	90.0	46.0	100.0	44.6	...	40.0	...	36.4	85.3
Commercial	3.1	10.0	2.2	0.0	2.0	...	1.5	...	1.5	14.7

Source: Ministry of Finance and Economic Development.

1/ Includes debt under negotiation to ensure comparable treatment.

Ethiopia: Summary of the Tax System as of end-December 2002

Tax	Nature of Tax	Deductions and Exemptions	Rates	
1. Taxes on income and profits Income Tax Proclamation No. 173/1961, as amended, By Proclamation No. 286/2002.	Tax on income from employment, including, without limitations, salaries, wages, allowances, directors' fees, and other personal emoluments. Employer withholds tax (withholding tax).	The first Br 150 of monthly income is exempted.	The marginal tax rates are as follows:	
1.1 Income tax on employment Proclamation No. 30/1992; Proclamation No. 107/1994; Proclamation No.286/2002.			Monthly taxable No. income (birr)	Marginal tax rate (%)
			1 151 - 650	10
			2 651 - 1,400	15
			3 1,401 - 2,350	20
			4 2,351 - 3,550	25
			5 3,551 - 5,000	30
			6 5,001 and above	35
1.2 Rural land and agricultural Activities income tax Proclamation No. 77/1997; Proclamation No. 152/1978; Proclamation No. 8/1995 (Oromia).				
1.21 Rural land use rent	An annual rent payable on rural land used for agricultural activities in Oromia regional state.	Agricultural investors are exempted for two-five years.	Farmers: Br 10 for the first hectare and Br 7.50 for each additional half hectare. State enterprises: Br 15 per hectare.	
1.22 Income tax	Tax payable on any annual income derived from agricultural activities.	Agricultural investors are exempted for two-five years.	For income less than Br 1,200 per annum: Br 15. For income of Br 1,200 per annum or higher, marginal tax rates are as follows:	
			Annual taxable No. income (birr)	Marginal tax rate (%)
			1 1,201 - 5,000	5
			2 5,001 - 15,000	10
			3 15,001 - 30,000	20
			4 30,001 - 50,000	30
			5 50,001 and more	40
			State farms owned by regional governments: 40 percent.	
1.3 Rental income tax Proclamation 286/2002.	Tax on income derived from the rent of houses or office buildings, manufacturing plants, materials and goods, etc. The tax is computed on the basis of annual rent income after deducting allowable expenses.	Annual depreciation and allowable expenses are deducted from gross income. The first Br 1,800 of annual income is exempted.	Annual taxable No. income (birr)	Marginal tax rate (%)
			1 1,801 - 7,800	10
			2 7,801 - 16,800	15
			3 16,801 - 28,200	20
			4 28,201 - 42,600	25
			5 42,601 - 60,000	30
			6 60,001 and above	35

Ethiopia: Summary of the Tax System as of end-December 2002

Tax	Nature of Tax	Deductions and Exemptions	Rates	
1.4	Tax on business and other profits			
1.41	Unincorporated business Proclamation No. 286/2002.	Tax on income from all sources other than those mentioned elsewhere,	The first Br 1,800 of annual taxable income is exempted.	No. Annual taxable income (birr) Marginal tax rate (%)
				1 1,801 - 7,800 10
				2 7,801 - 16,800 15
				3 16,801 - 28,200 20
				4 28,201 - 42,600 25
				5 42,601 - 60,000 30
				6 60,001 and above 35
1.42	Incorporated business Proclamation No. 36/1996. Proclamation No. 286/2002 as amended.	Profits tax.	-Awards for adopted or suggested innovations and cost saving measures -Public awards for an outstanding performance tax in any field. - income specifically exempted from income tax by the law in force in Ethiopia, by international treaty or by an agreement made or approved by the minister.	30 percent of taxable income.
1.5	Tax on income from mining activities Proclamation No. 53/1993; Proclamation No. 23/1996.	Tax on income received or credited from mining operations within Ethiopia by the holder of large- and small-scale mining licenses.	Artisan mining is exempted.	35 percent.
1.6	Capital gains tax Proclamation No. 286/2002.	Tax on gains realized from the increase in value upon the sale of shares, bonds, and urban houses.	Inflation adjustment and capital losses in the preceding year are deducted from the value of capital. Annual gains not exceeding Br 10,000 are exempted.	15 percent.
1.7	Other sources of income	Income from dividends paid to shareholders.	None.	10 percent.
		Income from chance winnings and lotteries.	Exemption for income not exceeding Br 100.	15 percent.
		Income from royalties.	None.	5 percent.
		Income of nonresident persons or organizations for services rendered to persons or organizations in Ethiopia.	None.	10 percent.
2.	Taxes on goods and services Proclamation No. 68/1993.			

Ethiopia: Summary of the Tax System as of end-December 2002

Tax	Nature of Tax	Deductions and Exemptions	Rates
2.1	Excise tax Proclamation No. 68/1993; Proclamation No. 77/1997; Proclamation No. 149/1999 Proclamation No. 307/2002	Excise tax is levied on selected list of locally produced and imported goods. The tax is collected within seven days of the preceding month of the production for local goods and at the time of clearing customs for imported goods. The rates are based on the cost of production or the c.i.f. value for imports.	None.
			Goods Tax rate (%)
			Any type of sugar (excluding molasses) 33
			All types of soft drinks (except fruit juice) 40
			Powder soft drinks 40
			Water bottled or canned in a factory 30
			Alcohol: Drinks
			All types of beer & stout, wine, and whisky 50
			Others alcoholic drinks 100
			All types of pure alcohol 75
			Tobacco leaf 20
			Tobacco and its products 75
			Salt 30
			Petroleum and its products 30
			Perfumes and toilet waters 100
			Leather, tanned or dressed 20
			Furs 50
			Textile and textile products 10
			Personal adornments 20
			Dishwashing machines (in homes) 80
			Washing machines (in homes) 30
			Video decks 40
			TV and video cameras
			TV broadcast receivers, radio, or sound receivers and reproducers 10
			Automobiles: up to 1300 cc 30
			1301-1800 cc 60
			above 1800 cc 100
			Carpets 30
			Asbestos and its products 20
			Clocks and watches 20
			Dolls and toys 20
2.2	Value Added Tax on goods and services. Proclamation No. 68/1993. Proclamation No.285/2002	Levied on locally produced goods at the manufacturing level or on imported goods at the import gate. The bases for taxation are the producer's wholesale price plus excise tax for local goods or the c.i.f. value plus customs duty and excise tax for imports. The tax is payable monthly within three to five days of the end of the month. For imported goods, the tax is collected at the same time as the customs duty.	-sales/transfer of used dwelling/lease -financial services -religious service -medical services and goods -educational/child-care services -humanitarian goods and services -electricity, kerosene and water -post office supplies -transportation -printed books -permits and license fees -import of gold and currency
			Fifteen percent tax rate applied on the value of all goods and services produced locally or imported.

Ethiopia: Summary of the Tax System as of end-December 2002

Tax	Nature of Tax	Deductions and Exemptions	Rates
2.3 VAT on services Proclamation No. 08/1993; Legal Notices No. 1/1994 and 3/1998. Proclamation No. 149/1999 Proclamation No. 285/2002	Value-added tax is levied on all services rendered locally. The tax is paid by the person or organization rendering services and computed on the basis of the service charge.	Water, electricity, and medical and educational services are exempted.	Fifteen percent on the rendering all services.
3. Tax on international trade			
3.1 Taxes on imports			
3.11 Customs duty Tariff Regulations No. 122/1993; Proclamation No. 67/1993; Tariff Regulation / 1998. Tariff Regulation / 2002	The customs tariff applies to all imports. Items are classified according to a schedule of 97 chapters, based on the Harmonized System of Tariffs Classification Code.	Diplomatic and consular missions, personal effects, grants and gifts to Ethiopia, firefighting instruments and appliances, trade samples, defense and public security equipment, materials and equipment for the handicapped, and sheath contraceptives are exempted. Exemptions and concessions are granted to certain organizations and items.	Ad valorem duty on imports consisting of six rates, ranging from 0 to 35 percent, as follows: Imports Tax rate (%) Raw materials, capital goods 0-10 Pharmaceuticals, and chemicals 0-20 Durable and nondurable Consumer goods 20-35 Luxuries and goods that can be produced locally 30-35 As specified in (2.1).
3.12 Import excise tax	Levied on selected imported goods.	None.	
3.13 Import Value Added tax	Value Added tax levied on imports; the basis for taxation is the c.i.f. value plus the customs duty and excise tax paid.	See items in (2.2) for exemptions.	As specified in (2.2).
3.2 Taxes on exports	All export duties and taxes except those on coffee are abolished.	Under the duty drawback scheme, goods produced for export, re-exporting or raw materials imported upon payment of duties are subject to refund of the duty paid. Ninety-five percent of the duty drawn back is refunded for raw materials or commodities if re-exported and 100 percent if exported after being processed or used for packing or containing. Under the duty free import scheme, persons or organizations wholly engaged for supplying their products to foreign markets are allowed a duty free purchase of local or imported raw material for their production, and the product should be exported within one year of the purchase of such raw materials.	

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Tax	Nature of Tax	Deductions and Exemptions	Rates
4. Other taxes			
4.1 Stamp duties Decree No. 26/1975, as amended by Proclamation No.110/1998.	Obligatory use of stamped paper for many legal documents, such as contracts or papers in court proceedings; requirement that stamps be affixed to other documents, such as property titles, power of attorney, notary acts, etc.	Stamp duties are not levied on documents where the Ethiopian government, foreign embassies, consulates, etc., would be the party subject to duty.	Varies according to the type document and value of transaction.
4.2 Withholding tax: Current payments of income tax at time goods are imported. Proclamation 227/2001	Tax collected at the time of import of goods for commercial use, where the collected tax is treated as tax withhold that is creditable against the tax payer.		Three percent
4.3 Income tax: Withholding of income tax on payments. Proclamation 227/2001	Category "A" taxpayers, government agencies, private nonprofit institution and NGOs withhold income tax on payments made to persons within categories specified, in the regulation No.75/2001.		Two Percent
4.4 Interest Income: Withholding of income Tax on deposit interest Income. Proclamation 227/2001	Payers of interest shall withhold income tax on the payment or crediting of interest paid or credited.		Five percent

Source: Ministry of Finance and Economic Development.