

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

**Interim Poverty Reduction Strategy Paper
Joint Staff Assessment**

Prepared by the Staffs of the IMF and IDA

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I. INTRODUCTION

1. The interim poverty reduction strategy paper (I-PRSP) prepared by the Ethiopian authorities contains a declaration of the Government's commitment to poverty reduction; a description of the existing extent and patterns of poverty; the main elements of its existing poverty reduction strategy; a three-year macro-economic framework as well as a three-year policy matrix; and a time-line and consultative process by which the full PRSP will be developed.
2. The Joint Staff Assessment of the I-PRSP is organized as follows. Section II discusses the key elements of the I-PRSP, section III provides an assessment of the weaknesses and risks of the I-PRSP, and section IV sets out staff's conclusions.

II. THE KEY ELEMENTS OF THE POVERTY REDUCTION STRATEGY

3. The I-PRSP states the government's commitment to poverty reduction. This commitment has been reaffirmed repeatedly since the Transitional Government of Ethiopia (TGE) replaced the socialist Dergue regime in 1991. Poverty reduction was one of the declared objectives of the first National Development Program of 1995 and of the second National Development Program (NDP) for 2000-05. The latter was developed in consultation with government administrative units of all levels and discussed with private sector organizations, and representatives from the spectrum of political parties. The I-PRSP draws on the new NDP, and in addition, states the government commitment to progress towards International Development Goals.
4. The interim PRSP went through a few rounds of redrafting to incorporate comments as a result of consultations with various government agencies, and the IDA, the Fund, the European Commission, the African Development Bank, and the broad group of United Nations agencies represented in Addis Ababa. In this context, a written communication

received by the Government, the Fund and the IDA from the European Commission suggests that in the full PRSP (i) the link between the ADLI strategy and poverty reduction be more explicitly developed; (ii) the Government make a specific effort on the issue of tracking poverty related expenditures; (iii) the Government give more specificity to objectives of the sectoral development programs, their timetables, financial resources, and implementation plans; and (iv) the indicators on malnutrition, vulnerability of the poor in general, and civil service/judicial reforms and capacity building be presented. In addition, a written communication from the Development Assistance Group (DAG)¹ further adds that the full PRSP should (i) examine whether overall vulnerability has worsened; (ii) indicate how to accelerate the implementation of the 1996 Food Security Policy; and (iii) address in detail issues of private sector development. The Government intends to deepen the participatory process during the preparation of the full PRSP, which will include contributions from the donor community as well the representatives of civil society.

5. Ethiopia has solid poverty data sources, including the Household Income, Consumption and Expenditure Survey of 1995/96; Welfare Monitoring Surveys of 1996, 1997, and 1998; the Ethiopian Rural Household Surveys of 1989, 1994, the 1997 Participatory Poverty Assessment; the March 1999 government report on “The Poverty Situation in Ethiopia;” and other sources. The I-PRSP provides a good if rather brief description of poverty in Ethiopia, including on the urban-rural divide. In addition, the document contains socio-economic indicators, such as life expectancy, infant and maternal mortality, and the illiteracy rate, that reflect poor living conditions prevalent in Ethiopia. However, a more comprehensive data analysis would be appropriate for the full PRSP; one that indicates the main causes of poverty and shows how these findings have influenced government policy for poverty reduction. A more detailed analysis is also required to identify particularly vulnerable groups, with disaggregation by region, gender and other relevant social categories.

6. The I-PRSP presents a broad outline for reducing poverty that is grounded in the development strategy laid out in the NDP. The poverty reduction strategy is centered around promoting economic growth and increasing the income-earning capacity of the poor. It comprises four main elements: (a) an agriculture-development-led-industrialization (ADLI) strategy, which is the core element for raising the income of the poor, (b) civil service and judicial reforms, (c) decentralization, and (d) capacity building. In addition, there are the traditional sectoral programs, notably in the health, education and road sectors that are integrated into the government budget and subject to regular public expenditure reviews.² The Government has also emphasized food security, development of a national policy for women, and launched a large and important program to combat HIV/AIDS. However, the

¹ DAG members include: Austria, Belgium, Canada, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom (DFID), USAID, UNDP, ADB, IFC, IDA, IMF, ILO, EU, FAO, UNICEF and UNHCR.

² However, capacity constraints, coupled with the conflict-related reallocation of resources during the past two years, have slowed the implementation of these programs below the initially targeted pace.

treatment of the various parts of the strategy in the I-PRSP is uneven. The attached policy matrix provides detail on many areas that are only briefly discussed in the text, but a better integration of the policy discussion and the matrix would be desirable.

7. The four key elements of the government's economic strategy aim to address the underlying causes of poverty in Ethiopia. The policies geared to agricultural development (ADLI) are undoubtedly a strong part of the government's poverty reduction strategy. This strategy is well explained, bringing to the fore the fact that in a country where 80 percent of the population live in rural areas, and most of them are engaged in subsistence farming, poverty reduction requires agricultural growth. The ADLI contains various components needed for agricultural growth, including technology, finance, rural infrastructure, internal and external markets and the role of the private sector. The strategy is also differentiated according to the requirements of ecological zones. ADLI, now in place for several years, has been already yielding significant gains in growth and poverty reduction. Actually, a large number of farmers have benefited, over the last five years, from the implementation of an ambitious program of extension services and the increased use of modern inputs (fertilizers and seeds). This has led to an increase in yields in areas covered by these programs, which has compensated for declining yields in other areas. The Government is addressing the problem of declining yields through "Dry Land Programs" which combine soil conservation with use of improved inputs.

8. The I-PRSP also identifies preliminary quantitative targets for various dimensions of poverty, such as educational and health status, as well as targets for increases in average income. These targets are consistent with progress towards the International Development Goals. In the full PRSP, the choice of the quantitative targets for other dimensions of poverty as well as of income inequality is to be further refined in order to provide appropriate benchmarks against which Ethiopia's progress can be evaluated. It is also desirable that the full PRSP link these quantitative outcome indicators to the intermediate output indicators that measure the results of public policy actions. Further reference to the monitoring system is lacking, as discussed below.

9. The macroeconomic framework included in the I-PRSP, is appropriately ambitious and consistent with goals of poverty reduction, in particular by promoting higher growth, and significantly increasing social expenditures, while restoring macroeconomic stability. The framework has been discussed with Fund and IDA staff and is expected to be presented to the IMF Board in February 2001 in the context of a program for which the authorities are seeking Fund support under the Poverty Reduction and Growth Facility (PRGF). The main macroeconomic targets to be achieved are: (i) annual real GDP growth of 7 percent between 2000/01 and 2002/03; (ii) containment of inflation to low single digit rates; (iii) reduction of the overall fiscal deficit (including grants) to less than 7 percent of GDP; and (iv) reduction of the current external deficit (including grants) to less than 6 percent of GDP.

10. The expenditure strategy builds on a substantial initial cut and a subsequent steady decline in regular defense spending (excluding demobilization costs), accompanied by restraint in other nonsocial current spending, in order to create room for increases in outlays

on health, education, infrastructure, agricultural services and other poverty-reducing services. Staffs believe that expenditure allocations to poverty targeted sectors are adequate and encourage the government to develop a closer budgetary link between expenditure allocations and outcome indicators. The government also targets significant increases in tax revenues (2½ percentage points of GDP over three fiscal years) by improving the efficiency of the tax system—through streamlining income tax legislation and refocusing on indirect taxation, as well as revamping tax administration. However, for the poverty-reducing outlays to reach levels commensurate with Ethiopia’s poverty strategy, the government needs debt relief from the enhanced HIPC Initiative.

11. The support from the HIPC Initiative will go towards increased expenditures in health, education, agriculture, and roads. The timing and availability of HIPC resources was uncertain when the I-PRSP was being written and the use of these funds could therefore not be discussed in the I-PRSP, but is described in the HIPC Preliminary Document which was prepared more recently. Although the efficiency and transparency of Ethiopia’s public expenditure management system is relatively high, continued progress on the Expenditure Management and Control Program will be needed to maximize the benefits from the HIPC Initiative.

12. The three-year policy matrix recognizes that the shift to high sustainable growth will require not only macroeconomic stability, but also structural reforms that address existing constraints on economic activity in Ethiopia. In particular, the I-PRSP has identified private sector development as one of the crucial steps in building the foundation for high, sustainable economic growth. Therefore, the authorities’ strategy seeks to further private sector development through (i) a greater role of the private sector in the provision of infrastructure, (ii) reducing the transactions costs of doing business by easing regulatory constraints, and (iii) more active export promotion, which would also include the introduction of bonded warehousing to facilitate duty-free access to inputs by exporters. The government is also seeking to make the business environment more predictable by modernizing its instruments of monetary management. On a broader scale, a number of reforms target financial sector development. It is expected that improvements in the health of the commercial banking system, as well as the further development of microfinance institutions and banks specializing in serving small and medium-sized enterprises will provide greater efficiency in allocating financial resources and improve incentives for financial savings.

13. The government intends to complete the full PRSP within one year after the I-PRSP is presented to the Boards of the IDA and the Fund. A draft PRSP based on the NDP, will be submitted for discussions with the donor community and the civil society. The latter includes NGOs; women groups; cooperatives; and, at the district level, civil servants and elected officials; at the regional level, private sector and urban communities; and at the federal level, professional associations and trade unions. After reflecting the consultative process, the PRSP will be submitted to the federal parliament and regional assemblies for approval.

III. WEAKNESSES AND RISKS OF THE POVERTY REDUCTION STRATEGY

14. In the view of the staff, the full PRSP should indicate more clearly the relationship between the poverty reduction strategy, the policy matrix, and the list of targets and indicators. More importantly, the I-PRSP does not mention how it proposes to monitor the implementation of the poverty reduction strategy, how it will relate to ongoing monitoring systems, which institutions will be involved, whether there will be any participation by civil society, or how the results will be made available to the public. A monitoring strategy that sets out these elements will be necessary for the full PRSP.

15. Little information is provided about how the full PRSP will be prepared (including the support to be sought from donors and the IDA and the Fund), and the timeline is vague. The government is considering setting up a steering committee to oversee the preparation of the PRSP. The I-PRSP is also weak on details of building broad ownership and support for the strategy in the full PRSP. Civil society and bilateral donors were not consulted during the preparation of the I-PRSP in part owing to a hurried timetable. The government intends to deepen the participatory process during the preparation of the full PRSP. In the coming months the government needs to develop an action plan to underpin this process and to specify how it plans to integrate the consultation results into the full PRSP.

16. The I-PRSP does not do full justice to past policy achievements and to already adopted poverty reducing policies; the full PRSP could include a more in-depth discussion. In addition, given the numerous sources of data available, the full PRSP should provide more comprehensive analysis of the poverty situation in Ethiopia (by regions, gender, and education). More generally, the challenge lies in prioritization and effective implementation of poverty reduction measures, i.e. in identifying those that will have—after taking costs into account—the highest impact on growth and poverty reduction, and ensuring that they are reflected in the macroeconomic framework. Also, further work is needed to establish explicit linkages, where possible, between public expenditures, outputs and poverty reduction outcomes.

17. The major risks to the Ethiopia's poverty reduction strategy are that:

- Given the prevalence of poverty among the population engaged in agriculture (especially manifested in food insecurity), as well as the unrealized potential of the sector, the staff agrees with the government's emphasis on agricultural growth. However, there is a risk that the potential of agriculture will not be realized, unless further reforms (i) improve the functioning of agricultural input markets; (ii) overcome implementation constraints encountered in developing irrigation and improving rural infrastructure; and last but not least (iii) streamline the land lease policy and improve legislation of agricultural land (including rights to use land as collateral).
- Staff notes – and it was also a concern of donor agencies and most donors – that the I-PRSP only briefly describes issues related to food security. Given the persistence of the structural food insecurity (affecting 2-3 million people every year), which is frequently

exacerbated by severe drought conditions, the staff recommends that a comprehensive food security strategy be developed in the full PRSP.

- Given the emphasis on agriculture, some other areas have not received adequate attention. More specifically, there is a risk that the government will not move quickly enough to stimulate the development of the urban based, formal private sector and exports. While the I-PRSP makes general reference to policy reforms aimed at removing hindrances to private sector development, specific reforms particularly in the area of urban land use and regulations affecting private investment will need to be developed and implemented decisively if the growth targets envisioned for the medium term are to be attained. Furthermore, the Ethiopian economy remains vulnerable to terms of trade shocks and frequent droughts. Without rapid growth of the private sector and exports, Ethiopia cannot achieve high and sustainable growth and significant poverty reduction.
- Slower than expected implementation of the recent peace agreement between Ethiopia and Eritrea could rekindle political tensions in the Horn region and result in higher than anticipated military expenditures. This could risk external financing support of the strategy by the donor community, and lead to reduction in resources available for social and other poverty reducing expenditures. In addition, the instability in the region might discourage both domestic and foreign investors, and thus further jeopardize high and sustainable growth.
- There is a risk that implementation of the reform program laid out in the I-PRSP will be slower than planned because of limited capacity in both the public and private sectors. This particularly applies to the health and education sectors, which in the past experienced difficulties with implementing programs. There is a risk that, without strengthening public expenditure management and reducing other institutional weaknesses, the programs might falter once again and the targets will not be reached.

IV. CONCLUSIONS

18. In the view of staffs of the World Bank and the Fund, the Ethiopian Government's I-PRSP contains both strengths and weaknesses, but overall it has the necessary elements required for an I-PRSP. The staff is also confident that, given Ethiopia's track record of implementing reforms aimed at growth and poverty reduction, and commitment to the policies described in the I-PRSP, the listed weaknesses and measures to mitigate risks will be addressed in the full PRSP.

19. The staffs of the IDA and Fund consider that the I-PRSP of the Ethiopian Government provides a sound basis for the development of a fully participatory PRSP, and for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the IDA and the Fund reach the same conclusion.

Key IDA/Fund Events Related to the PRSP in 2001

Institution	Event	Expected Date
IMF/IDA	HIPC Preliminary Document	February
IMF	Board consideration of PRGF arrangement	February
IMF/IDA	Public Expenditure Review mission	February
IDA	Economic Recovery Support Credit	April
IMF	Review of the PRGF arrangement	July
IMF/IDA	JSA of PRSP	Fourth quarter
IDA	CAS	Fourth quarter