Ethiopia

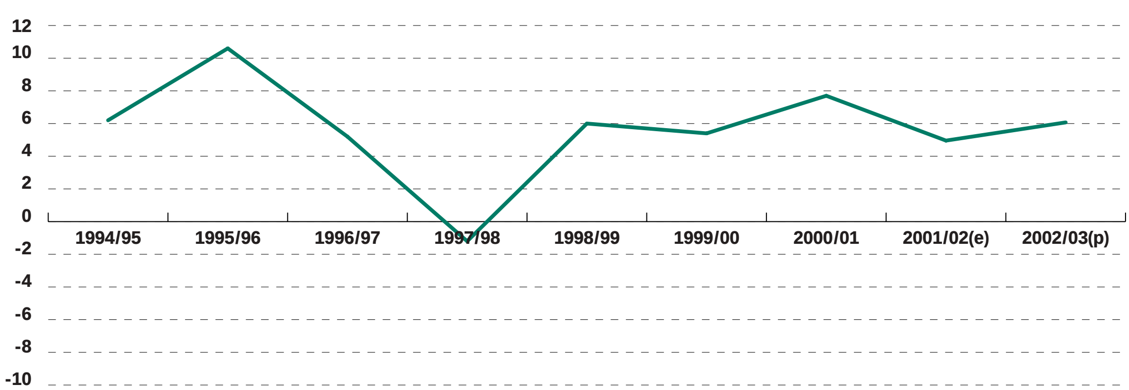
key figures

• Land area, thousands of km^2	1 104
• Population, thousands (2001)	64 459
• GDP per capita, $ (2001)	97
• Life expectancy (2000-2005)	43.3
• Illiteracy rate (2001)	60.4

ETHIOPIA IS MAKING STEADY PROGRESS in economic growth. In 2000/01, real GDP growth reached 7.9 per cent, from a yearly average of 4.8 per cent since 1994/95. Notwithstanding the growth upsurge, per capita income in Ethiopia has continued to decline since 1997/98. The growth performance is expected to moderate with an estimated growth rate of GDP of 5 per cent in 2001/02, which will rise to 6 per cent in 2002/03. In effect, Ethiopia's declining per capita income is expected to continue in the short term. In line with its Poverty Reduction Strategy Paper (PRSP) commitments, the government has put poverty reduction at the centre of its medium-term growth strategy. Ethiopia's economic management is improving, underlined by fiscal and monetary prudence. The government's recent fiscal performance is marked by success in orientating spending from defence to poverty-targeted outlays. However, weak expenditure management is hampering progress towards fiscal stability. Further increases in government expenditure are expected to outweigh revenue gains leading to continuing deterioration in the budget position in the short term. Prudence in monetary management is slowing down the expansion of monetary aggregates which, in turn, is contributing to declining inflation, stability in interest rates and the foreign exchange rate of the birr. Ethiopia's external sector is prone to movements in the international price of coffee. Recent declines in international coffee prices have

Recent fiscal performance in Ethiopia is marked by a reorientation of spending from defence to poverty reduction

Figure 1 - Real GDP Growth[a]



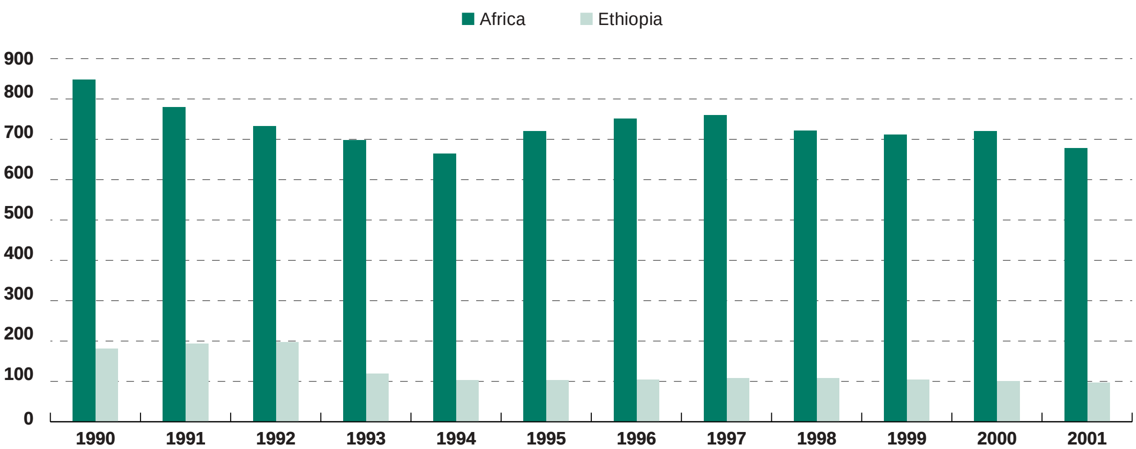
a. The percentage scale is different from the other countries since GDP growth exceeded the level of 10 per cent.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

translated into falling export revenue and deteriorating terms of trade. However, in 2000/01 a contraction in imports and increased current transfers contributed to improvement in the current account. The outlook on the external position is for further deterioration in the trade deficit as imports rise faster than exports. Ethiopia reached the decision point in the Heavily Indebted Poor Countries (HIPC) initiative in November and is expected to benefit from significant debt relief. Since embarking on the road to liberalisation in the early 1990s, privatisation has been a major plank of the government's reform agenda. The privatisation programme began in 1994 and, by April 2002, the government had divested 200 enterprises and planned to sell a further 113 by 2003/04. It is, however, unlikely that the target will be met given the slow pace at which the programme had travelled. It is also not certain whether the government has a clear timetable as to when the programme is to be completed. The political environment in Ethiopia is relatively stable and the government is making a determined effort to strengthen governance and democratic institutions in the country. Ethiopia now has improved relations with its neighbours and despite the fact that normalisation of relations with Eritrea is yet to be achieved, peace continues to prevail between the two neighbours.

Recent Economic Developments

Ethiopia continues to make steady progress in economic growth since emerging from conflict with Eritrea in 2000. Real GDP growth in 2000/01 maintained an upward trend at 7.9 per cent from 5.4 per cent in 1999/00 and the yearly average of 4.8 per cent during 1994/95-1998/99. A number of factors contributed to the improved growth performance in 2000/01. First, the agricultural harvest expanded sharply; the biggest expansion in five years. Second, higher inflows of external aid after the end of the war enabled Ethiopia to withstand shortfalls in export earnings. Third, economic performance gained from macroeconomic stability, with the fiscal deficit narrowing and the growth in monetary aggregates slowing down. Ethiopia's growth performance in 2000/01, however, did not reverse the declining trend in income per head, which the country has been witnessing since 1997/98.

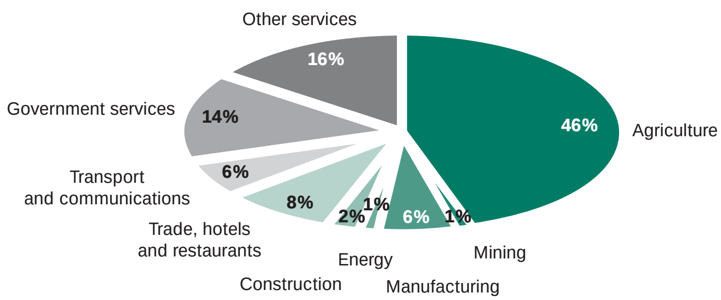
Figure 2 - GDP Per Capita in Ethiopia and in Africa (current $)



Source: Authors' estimates based on IMF data.

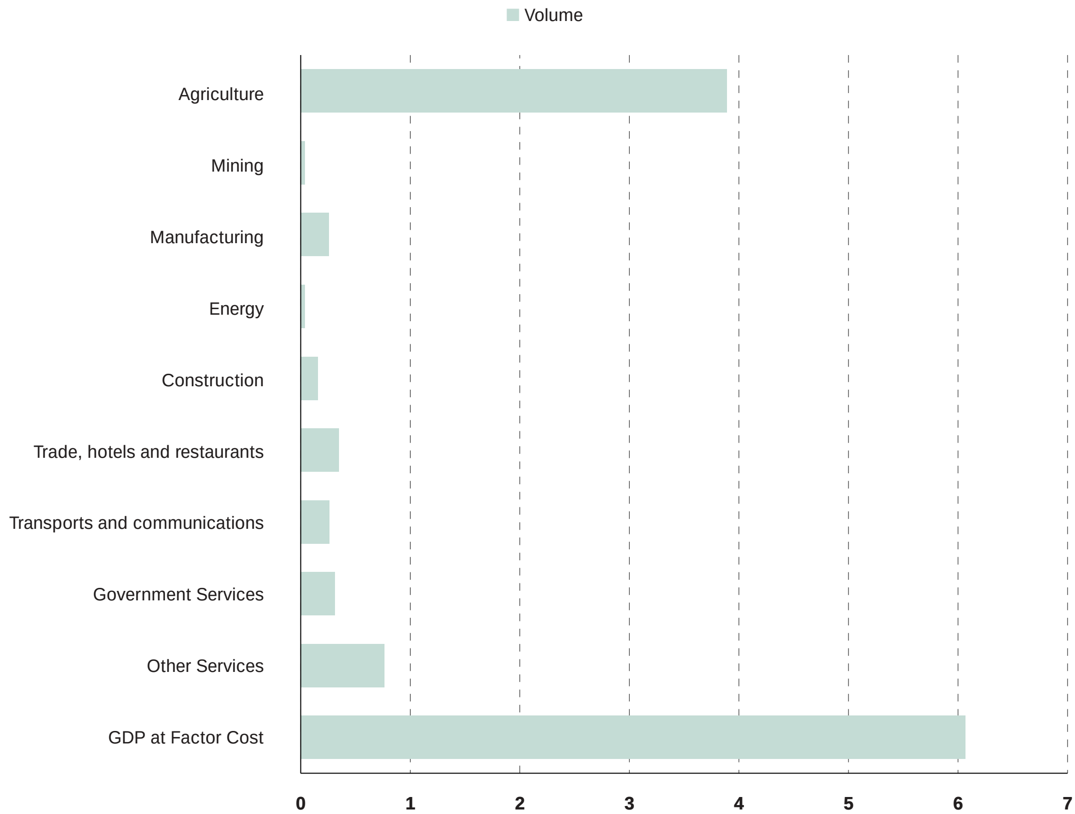
The strong growth in total output in 2000/01 was reflected in all sectors of the economy. Agriculture remained the mainstay of the economy, increasing its share in total GDP to 45.1 per cent in 2000/01 from 43.6 per cent of GDP in 1999/00. The agricultural sector expanded strongly in 2000/01 with a real growth rate of 11.5 per cent, compared with 2.9 per cent in 1999/00. The strong growth in agricultural production in 2000/01 was due largely to improved weather conditions. The food crop sub-sector spearheaded the agricultural sector expansion. In spite of delayed and patchy rains during late 2001 in the grain producing areas of central and southern regions, the main crop (*meher*) harvest came in above average registering about a 25 per cent increase to 16.5 million tonnes, the biggest expansion in five years. The good performance of crop production has continued into the minor agricultural season (March-May) 2002 as the good weather conditions had lasted. Significantly, Ethiopia has adopted some unique solutions to its perennial drought situation. Parts of northern Ethiopia, which were badly hit by famine a generation ago, are now exporting a food surplus. A unique scheme in the Axum area is working to conserve water and improve soil fertility by shoring up walls of fields to conserve the soil, stopping over-grazing, and stopping the use of chemical fertiliser in favour of compost. Nonetheless, field appraisals in the major crop-producing areas by the Disaster Prevention and Preparedness Commission (DPPC) of Ethiopia have revealed a shortage of traditional maize seeds, which has forced farmers to plant second and third generation hybrid maize with potential yield reductions of up to 40 per cent if planted with fertiliser and further reductions if planted without fertiliser. Consequently, the *belg* season maize production may be expected to come in lower in 2002 than the 2001 *belg* harvest. Also, notwithstanding the recent improvement in food production, Ethiopia continues to need large quantities of food aid, with some chronic food insecurity in areas such as parts of eastern Tigray and the Amhara and Oromiya regions that require over five months of food aid in a year. In addition to the generally poor agricultural output in these areas, inadequate infrastructure continues to make effective food distribution from areas of plenty to such shortage areas difficult. In contrast to the improving output of food crops, the production of coffee — the main cash crop — continued the declining trend of the past three years in 2000/01. Coffee output fell by 3.9 per cent in 2000/01 to 221 000 metric tons from 230 000 metric tones in 1999/00. This declining trend has continued into the first quarter of 2001/02 with a fall in output of about 35 per cent compared with the same period in 2000/01. The persistent decline in the international price of coffee has contributed to declining domestic producer price, which has been a major disincentive to improved production. In the three years preceding end-2000/01, coffee export prices declined by 37 per cent. This trend continued in the first three months of 2001/02 as coffee export prices fell by 3 per cent against the 2000/01 average export price. Consequently, the domestic producer price of coffee has also followed a downward trend. The domestic price of coffee fell by 14.1 per cent in 1998/99 and was maintained at birr 11 510 per metric ton in 1999/00. The price fell by 18.3 per cent in 2000/01 to birr 9 406 per metric ton. A further decline in the producer price by 13.9 per cent to birr 8 099 was experienced during the first quarter of 2001/02. The government has shown concern of developments in the coffee sector by implementing a number of measures: *i)* the 6 per cent coffee export tax will not be collected if the export prices fall below 70 cents per lb. for unwashed coffee and 105 cents per lb. for washed coffee (coffee prices have remained below this floor since August 2000, and export taxes have not been collected since May 2001); *ii)* suspension of the 5 per cent withholding income tax on proceeds from coffee exports; and *iii)* eased restrictions on the domestic sales of export-quality coffee and the transfer of coffee between regions. In addition, to prevent cash shortfalls, banks extending credit to middlemen (called wholesalers) have been refinancing their loans as needed. This benefits small producers as well, since wholesalers often finance producer activities. Furthermore, the Coffee and Tea Authority has been encouraging exporters to meet market demand at lower prices. The government is also making other efforts to boost production and exports. These include *i)* increasing exports of washed coffee, which commands a premium and constituted 24 per cent of coffee exports in 2000/01, up from 17 per cent in 1996/97; *ii)* preparing for the certification of organically grown Ethiopian coffee;

Figure 3 - GDP by Sector in 2000/01



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - Sectoral Contribution to GDP Growth, 2000/01



Source: Authors' estimates based on IMF and domestic authorities' data.

and *iii)* reducing state participation in the sector as well as considering moving from the present auction system to a commodity exchange for coffee exports.

The industrial sector accounted for 10.5 per cent of GDP in 2000/01, up from 8.8 per cent of GDP the previous year. The growth performance of the sector also rose in 2000/01 to 5.8 per cent from 1.9 per cent in 1999/00. The improved performance of the industrial sector reflected some success of the government's privatisation programme that has brought into production some hitherto dormant manufacturing and agro-processing industrial establishments. The improved industrial performance was, however, largely as a result of the improved agricultural production that increased the availability of raw materials especially for food processing industries. Manufacturing output expanded by 5.4 per cent in 2000/01, up from 3.6 per cent the previous year. Mining and quarrying continued to grow strongly at 8.9 per cent in 2000/01, though below the 9.5 per cent achieved in 1999/00. At the same time, mining continued to make only a small contribution of just 0.5 per cent of GDP in 2000/01, reflecting the largely untapped situation of the sub-sector.

The services sector accounted for 44.4 per cent of GDP in 2000/01, slightly down on its share of 45.6 per cent in 1999/00. Growth in the services also slowed to 4.8 per cent in 2000/01 from 9 per cent in the previous year. In 2000/01, the distributive services accounted for 14.7 per cent of GDP while other services contributed 29.7 per cent of GDP. The main growth engine in the services during 2000/01 was social services, especially education and health, as the government diverted increased resources to these activities. Education services expanded by 13.1 per cent in 2000/01, up from 8.8 per cent in 1999/00, while health services increased by 8 per cent in 2000/01, from a decline of almost the same magnitude the previous year.

Table 1 - Demand Composition (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2003(p)
Gross capital formation	**16.4**	**16.3**	**15.3**	**18.0**	**21.4**	**21.6**
Public	7.5	7.9	5.3	8.9	11.7	11.9
Private	9.0	8.4	9.9	9.2	9.7	9.8
Consumption	**92.6**	**98.6**	**100.1**	**97.8**	**95.9**	**96.8**
Public	11.9	18.5	23.2	17.5	18.2	17.6
Private	80.7	80.2	76.8	80.2	77.7	79.2
External sector	**-9.0**	**-14.9**	**-15.3**	**-15.8**	**-17.3**	**-18.5**
Exports	14.5	14.2	15.5	15.4	17.1	17.3
Imports	-23.5	-29.1	-30.8	-31.2	-34.4	-35.7

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

The expenditure composition of GDP shows a significant fall in the share of total consumption in GDP in 2001, due solely to a fall in public consumption. The fall in public consumption reflected the government's move away from war, which enabled productive resources to be devoted to investment, especially in the private sector. The reduced share of public consumption is expected to be maintained in 2001/02 and 2002/03. This will enable gross investment to rise in both years.

Macroeconomic Policy

Fiscal and Monetary Policy

Since emerging from war in 2000, Ethiopia has made some gains in fiscal management, which continued in 2000/01. However, progress in fiscal management is hampered by a relatively weak expenditure management system, mainly as a result of the degree of decentralisation to the regions; insufficient management capacity, particularly at the regional level; and lack of computerisation. The overall fiscal deficit narrowed from 11.4 per cent of GDP in 1999/00 to 5.7 per cent of GDP in 2000/01, reflecting both improved revenue situation and tighter control on expenditure. The improved fiscal situation was achieved despite what, according to the government, was a tight treasury situation resulting from a small revenue shortfall and uncertainty on the disbursement of donor funds. The major feature, however, of the government's fiscal performance in 2000/01 was its success in orientating spending from defence to poverty-targeted outlays. Although the government's budget position is expected to benefit from the revenue-enhancing measures, estimated higher government expenditure in 2001/02 and 2002/03 will lead to further deterioration in the budget situation. The primary deficit is estimated to rise to 7.4 per cent of GDP in 2001/02 and is projected at 7.2 per cent of GDP in 2002/03.

The government's total revenue increased from 21.6 per cent of GDP in 1999/00 to 24.6 per cent of GDP in 2000/01, reflecting increases in domestic revenue and external grants. The improving revenue situation has continued into 2001/02 with the government reporting that during the first quarter of 2002, fiscal performance was better than programmed, with revenues exceeding projections. The government's tax reforms are delivering an increase in tax revenue, which rose to 14.3 per cent of GDP in 2000/01 from 12.4 per cent of GDP in 1999/00. The government has accelerated the pace of its tax reform programme. A new Ministry of Revenues has been established and the revenue department has been moved from the Ministry of Finance and Economic Development to the new ministry in an effort to improve tax collection and to combat fiscal fraud. Following the increase in the sales tax and the removal of the import duty surcharge in 2000, a new legislation on presumptive taxation and a 5 per cent withholding tax on imports became effective in February 2001. In March 2001, legislation was approved to introduce the tax-payer identification (TIN) to reinforce the collection powers of revenue agencies, and a tax reform implementation task force was established. In July 2001 a large taxpayer unit was made operational and, in October 2001, a draft VAT legislation was submitted to Parliament regarding the planned introduction of VAT by January 2003. These measures are being assisted by the IMF, which increases the chances of effective implementation. In preparation for the introduction of VAT, the government initiated from the start of 2002 a number of processes including, the design and computerisation of the taxpayer registration process; the operational development of taxpayer services activities, return process and debit and audit activities; and publicity campaign and taxpayer education. The government submitted to parliament in June 2002 a revised income tax law, which includes enhanced enforcement procedures and an improved penalty regime, with a view to increasing the efficiency of income tax collection, and ensuring the recovery of income tax arrears. These measures are expected to lead to improvement in the government's revenue position, with the tax revenue estimated to rise to 15.8 per cent of GDP in 2001/02 and further to 16 per cent of GDP in 2002/03. Consequently, total government revenue is estimated to rise to about 26 per cent of GDP in 2001/02 and is projected to be maintained at that share the following year.

On the expenditure side, in 2000/01 the government was successful in increasing expenditure targeted at poverty reduction, even though total expenditure fell from 33.1 per cent of GDP in 1999/00 to 30.4 per cent of GDP. Poverty reduction expenditure that focused on improving delivery of services that have an impact on human development (health and education), and on increasing the opportunities for and efficiency of income earning activities (especially in agriculture and road infrastructure) increased from 4.5 per cent of GDP in 1999/00 to 5.2 per cent of GDP in 2000/01. Capital expenditure also increased from 6.6 per cent of GDP in 1999/00 to 9.6 per cent of GDP in 2000/01. The government also nearly doubled the minimum wage of civil servants (from birr 105 to birr 200) with effect from January 2002. In its effort to improve expenditure management, the government is implementing, within the Expenditure Management and Control Programme, a comprehensive short- and medium-term plan to enhance budget formulation, execution, and reporting at the federal and regional levels. The government is aiming to consolidate federal and regional budgets — including all extra budgetary funds and accounts — for both the past year and the budget year by end-2002. In spite of these measures, government expenditure will continue to rise. For 2001/02, total expenditure is estimated to increase to 36.1 per cent of GDP, and is projected to moderate at 35.5 per cent of GDP in 2002/03.

Ethiopia's monetary policy has been geared towards containing inflation and achieving an international reserve target; this policy was maintained in 2000/01.

Table 2 - Public Finances[a] (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03(e)
Total revenue and grants[b]	**20.8**	**21.5**	**21.6**	**24.6**	**26.4**	**26.1**
Tax revenue	11.5	11.4	12.5	14.3	15.8	16.0
Grants	3.3	3.3	3.3	5.1	5.2	4.8
Total expenditure and net lending[b]	**24.8**	**31.9**	**33.1**	**30.4**	**36.1**	**35.5**
Current expenditure	15.5	21.7	26.5	20.0	23.3	22.7
Excluding interest	*12.9*	*19.7*	*24.3*	*17.9*	*21.0*	*20.5*
Wages and salaries	5.6	6.0	6.8	6.9	7.9	7.3
Interest on public debt	2.6	2.1	2.2	2.1	2.3	2.2
Capital expenditure	9.3	10.2	6.6	9.6	12.8	12.9
Primary balance	**-1.4**	**-8.4**	**-9.3**	**-3.7**	**-7.4**	**-7.2**
Overall balance	**-4.0**	**-10.5**	**-11.5**	**-5.7**	**-9.7**	**-9.4**

a. Fiscal year begins 1 July.
b. Only major items are reported.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

The Net Domestic Asset of the Bank of Ethiopia (NBE) remained the key aggregate in steering monetary policy. During 2000/01, the government continued to sterilise excess liquidity in the system, and took steps to adopt indirect monetary management instruments. The government also continued moves towards market determination of interest rates and exchange rates. In order to enhance the use of indirect monetary management and to reduce excess liquidity, the NBE had introduced in November 2000 a two-year government bond, which served to mobilise most of the excess reserves in the banking system. Also, the government currently conducts regular bi-weekly Treasury bill auctions to raise government funding and/or manage liquidity at the margin. In order to facilitate liquidity management, the NBE introduced a rediscount facility for eligible government paper in March 2001. These developments, in addition to the government's prudent fiscal actions, contributed to a slowdown in the growth of broad money to 9.5 per cent in 2000/01 from 14 per cent in 1999/2000. The growth of monetary aggregates continued on a cautious note, with the growth rate of broad money at 3.6 per cent during the first quarter of 2001/02, in line with the annual target growth rate of 11.1 per cent. During 2000/01, net credit of the NBE to the government declined rapidly by 30 per cent as the government relied more on borrowing from commercial banks. Increased sales of government securities reduced banks' excess reserves from 29.6 per cent of deposits in September 2000 to 5.3 per cent in July 2001; the ratio, however, rose again to 9.7 per cent in September 2001 before falling to 5.2 per cent by end-October 2001. Interest rates remained stable throughout 2000/01. The average rate on the benchmark 91-day Treasury bill was about 3 per cent in 2000/01, down on the average 3.6 per cent in 1999/00. Commercial banks average savings rate was also stable at around 6 per cent in 2000/01 as in the previous year. There was, however, a marginal increase in the average lending rate of commercial banks to about 14 per cent in 2000/01, from 13.5 per cent the previous year underlying the uncompetitive nature of the banking system. Due in part to the slow growth of monetary aggregates and largely as a result of improved agricultural production coupled with the availability of food aid, consumer prices fell by nearly 7 per cent in 2001. The outlook on inflation is for consumer prices to fall again by an estimated 7 per cent in 2002. However, the rate of inflation is expected to take an upward turn at a projected annual rate of 4.3 per cent in 2003 with the upsurge in economic activity.

On the foreign exchange market, Ethiopia is aiming to achieve a flexible market, and the government continues to eliminate exchange restrictions to enhance the market's efficient and smooth operation. In March 2001, the NBE lifted the restrictions on the purchase of foreign exchange for holiday travel and education purposes. This was followed by the termination of the weekly wholesale foreign exchange auction and its replacement by the inter-bank market in October 2001. The government has committed itself to ensuring that a spread of more than 2 per cent does not arise between the NBE's buying and selling rates and those of the commercial banks. The birr was relatively stable depreciating against the US dollar by only 2.9 per cent during 2000/01. The stability has been maintained into 2001/02, with the value of the birr falling against the dollar by only 0.7 per cent in the first quarter of 2002.

External Position

Ethiopia continues to make progress towards liberalising its external environment by the progressive lowering of its average tariffs. Currently, all export taxes have been eliminated, except the export duty on coffee in special circumstances. Since the beginning of 2002, the government has carried out a study on effective protection towards its intention of reducing the average import tariff from the existing level of 19.5 per cent to 17.5 per cent by January 2003, as well as lowering the maximum tariff rate from 40 per cent, and reducing the number of bands from seven to four.

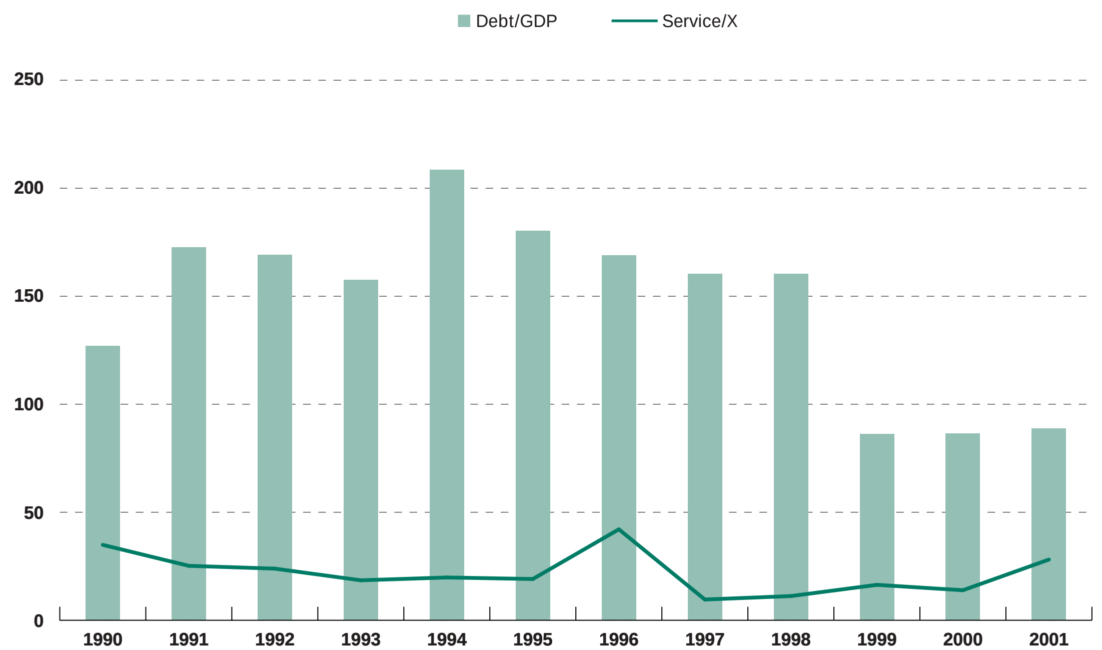
Ethiopia's external payments situation has been prone to the recent declines in international coffee prices. The poor performance of international coffee prices over the past three years continued to lead to deterioration in the terms of trade of Ethiopia and its export earnings. Total exports of goods declined by about 9 per cent from $486 million in 1999/00 to $441 million in 2000/01 reflecting solely the fall in export receipts on coffee. The value of coffee exports declined by about 33 per cent in 2000/01 following the declines of 6 per cent and 33 per cent in the previous two years respectively. The export sector also continued to suffer from illegal cross-border trade. The value of illegal trade in live animals, hides, and skins is estimated at nearly $85 million in 2001. Total imports also declined to $1 558 million in 2000/01 from $1 611 million in 1999/00. This contraction was due to a lower fuel bill. Due in part to the contraction of the import bill, and largely as a result of the increase in current transfers with the end of the war, the current account balance contracted from a deficit of 5.3 per cent of GDP in 1999/00 to a deficit of 4.2 per cent of GDP in 2000/01. The overall balance of payments position gained from significant improvement in the capital account from a deficit of $31 million in 1999/00 to an estimated surplus of $212 million in 2000/01. The sharp improvement was the result of continued funding of Ethiopia's demobilisation, reconstruction and sector development efforts by bilateral and multilateral donors. The outlook on the external position is for the trade account to deteriorate further as imports rise

Table 3 - Current Account (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03(e)
Trade balance	-10.4	-16.7	-17.7	-17.9	-19.7	-20.5
Exports of goods (f.o.b)	7.9	7.5	7.6	7.1	7.9	8.1
Imports of goods (f.o.b)	-18.3	-24.2	-25.3	-25.0	-27.5	-28.6
Services, net	2.1	1.8	2.3	2.2		
Factor income, net	-1.0	-0.8	-0.9	-0.9		
Current transfers, net	10.8	7.8	11.0	12.4		
Current account balance	**1.5**	**-7.9**	**-5.3**	**-4.2**		

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank.

faster than exports. Thus, Ethiopia will continue to need further improvements in current transfers so as to prevent the current account position from worsening.

Ethiopia's external debt stock was estimated at $5.1 billion at end-2001. This amount was shared between multilateral creditors, 51 per cent; official bilateral creditors, 46 per cent of which debt to Paris Club creditors was 30 per cent; and commercial creditors, 2 per cent. Ethiopia reached the decision point for debt relief under the enhanced HIPC initiative in November 2001. Ethiopia had earlier in March 2001 received supplementary debt relief from the Paris Club of official donors. The annual savings of Ethiopia's debt relief will average about $96 million a year over the next three decades. With this relief, the debt service ratio of the country is expected to halve, from about 16 per cent to 7 per cent by 2003, falling to below 4 per cent by end-2021.

Structural Issues

Since Ethiopia embarked on the road to reforms in 1992, the government has been implementing measures to increase growth and poverty alleviation through private participation in the economy. As the country still faces the challenge of real transformation from a centrally planned economy, the government has intensified efforts at removing the legacy of a controlled economy. Since coming out of war in 2000, and with the assistance of the World Bank and the IMF, Ethiopia is making progress in reforms that are conducive to growth and poverty reduction. Reforms currently being undertaken include: *i)* civil service reform with the planned adoption of the civil service proclamation on code of conduct, and the implementation of a medium-term wage policy; *ii)* capacity building in key ministries such as the Ministry of Revenues, Ministry of Finance and Economic Development, the judicial system, at the regional and district levels, and through the establishment of industrial training institutions and private sector associations; *iii)* agricultural reform, particularly the adoption and implementation of an action plan to improve efficiency of agricultural input market, the review, in co-operation with the regions, of rural land proclamation to ensure efficient land lease policy, and training programme for farmers; *iv)* legal and regulatory reforms, including the adoption of a revised competition law, and a review of the implementation of the urban land lease policy; *v)* the restructuring of utilities, including through private participation and the introduction of regulatory frameworks; and *vi)* the continuation of the privatisation programme of parastatals.

Ethiopia's privatisation programme started in 1994 and, although it has evolved and changed in some perspectives, it still works along the main objective of the Ethiopian Economic Policy launched in 1991. It is still designed to support the economy on its way to sustainable development and growth. The government established the Ethiopian Privatisation Agency (EPA) in 1994 to implement the programme, which started with the privatisation of small retail trade outlets and hotels as well as small-scale manufacturing and agro-processing enterprises. The reason was for the government to gain first-hand experience, which could be used in later privatisation of medium- and large-scale enterprises whose privatisation could be more complex. As a matter of policy, bids for the retail trade outlets, stores, small hotels and restaurants as well as small-scale manufacturing enterprises and dairy farms were floated for domestic investors alone in a sale of 100 per cent ownership interest. For other enterprises, the EPA has invited investors, local and foreign, to participate in either joint expansion or improvement programmes with the government or in the acquisition of full ownership of the enterprise. By April 2002, the government had privatised 200 enterprises, and has planned to privatise another 113 enterprises over the period 2002/03-2003/04. The government intimates that the necessary preparations are underway for the privatisation of 81 enterprises with the help of foreign consultants and for 32 others on which in-house staff have carried out preparatory work. Yet it is difficult to see how the planned privatisation will be achieved given the slow progress being made so far. For instance, in 2000/01 the government offered for sale 14 enterprises that had been offered for bid more than once; only seven attracted bids. Even then, three bids have as yet not been awarded with, in the case of two (Addis Ababa Tannery S.C. and Tikur Abay Shoe S.C.), the bidder unable to fulfil the requirements of the EPA while, in one (Kombolcha Tannery S.C.), the bidder had set preconditions for the EPA. Also, the slow progress of the Ethiopian privatisation programme is not only in the sense of timing. It is still not certain whether the government has a clear timetable as to when it wants to rid itself of the state institutions and close shop.

In its financial sector reforms, the government has pursued several measures to improve the competitiveness of the financial sector. The government's objectives are to achieve a sound financial sector that would foster economic development and active competition in Ethiopia by offering an attractive range of financial savings instruments throughout the country and provide for an efficient allocation of financial resources to borrowers. In 2001, the government updated its medium-term financial sector strategy. The measures taken included *i)* the adoption by the NBE in March 2002 of regulations for the provisioning of non-performing loans and other doubtful assets in line with international best practices; *ii)* allowing a bankers' association to be formally established; *iii)* taking steps to strengthen the NBE, following the completion of the ongoing comprehensive study of the NBE, including revising the existing Banking Act to increase the NBE's autonomy; *iv)* ensuring that the Construction and Business Bank of Ethiopia is brought to the point of sale after its balance sheet has been restructured, based on the NBE's recommendations; *v)* starting to implement a restructuring plan to address the weak financial condition of the Development Bank of Ethiopia; *vi)* encouraging public entities to do business with all banks of their choice; and *vii)* allowing private banks to enter into management contracts with foreign institutions.

The government also took special measures, in line with IMF/World Bank technical assistance, to strengthen the Commercial Bank of Ethiopia (CBE), which still dominates the financial market with over 80 per cent of bank deposits and about 60 per cent of bank loans. The government signed a management contract with a foreign bank in June 2001. This contract, however, did not enter into force as the foreign bank withdrew from the contract in January 2002. However, following a sharp deterioration in the financial position of the CBE in 2001, which saw non-performing loans increasing from about 29 per cent of total loans at end-2000 to 39 per cent at end-2001, the government has since the beginning of 2002 taken the following measures: first, a new management was appointed to operate CBE on a commercial basis; second, a performance contract was signed between the government and the new CBE management in June 2002; third, to assist the new management, the CBE will be concluding a twinning arrangement with – or hire consultants from — reputable foreign institutions. In order to improve the financial situation of the CBE, the government further directed that there will be no new lending from the Central Bank to CBE. Also, lending authority will be transferred from the Board of CBE to management. Further, following the allegation of corrupt practices at CBE by the Ethiopian anti-Corruption Commission, 28 past CBE officials, 13 current managers (including the President and Vice President of CBE), and 12 private sector borrowers were arrested.

Political and Social Context

Ethiopia is a functioning democracy with the government making continuing efforts to strengthen governance and democratic institutions in the country. The country held general elections in May 2001 and a new president was elected by parliament in October 2001. The government then carried out an organisational restructuring including reducing the number of ministries from 25 to 18 and creating three co-ordinating ministries, namely Rural Development, Capacity Building and Infrastructural Development. The government is also preparing a National Capacity Building Programme which, with the Ministry of Capacity Building, are important responses to the capacity constraint in the country.

Ethiopia now has improved relationships with its neighbours. Following the signing of a peace accord with Eritrea in 2000, both governments have accepted the verdict of the UN Border Commission. However, there is still tension between the two neighbours as the actual border demarcation has not been effected and normalisation of relations is yet to be achieved. However, peace continues to prevail due to the efforts of both countries and the 4 200 members of the UN mission in Ethiopia and Eritrea. There has also been internal political tension due to the rift in the ruling Tigray Peoples' Liberation Front (TPLF) in 2001 that created political uncertainty and led to the arrests of prominent members of the ruling coalition and key businessmen on charges of corruption. However, there are allegations that some of the arrests were politically motivated thus casting some doubt on the real motive behind the arrests.

The government is beginning to address the problem of corruption in the country, which had also raised concerns of human rights abuses. Following the dismissal and detention of the country's deputy prime minister in 2000, several other public officials were removed on corruption charges though most were not brought before the courts. This led to charges that the dismissals were political rather than ethical. In May 2001, the government created, in the prime minister's office, the Federal Ethics and Anti-Corruption Commission (FEACC). The FEACC filed charges against some of the politicians and businessmen that were arrested in 2000.

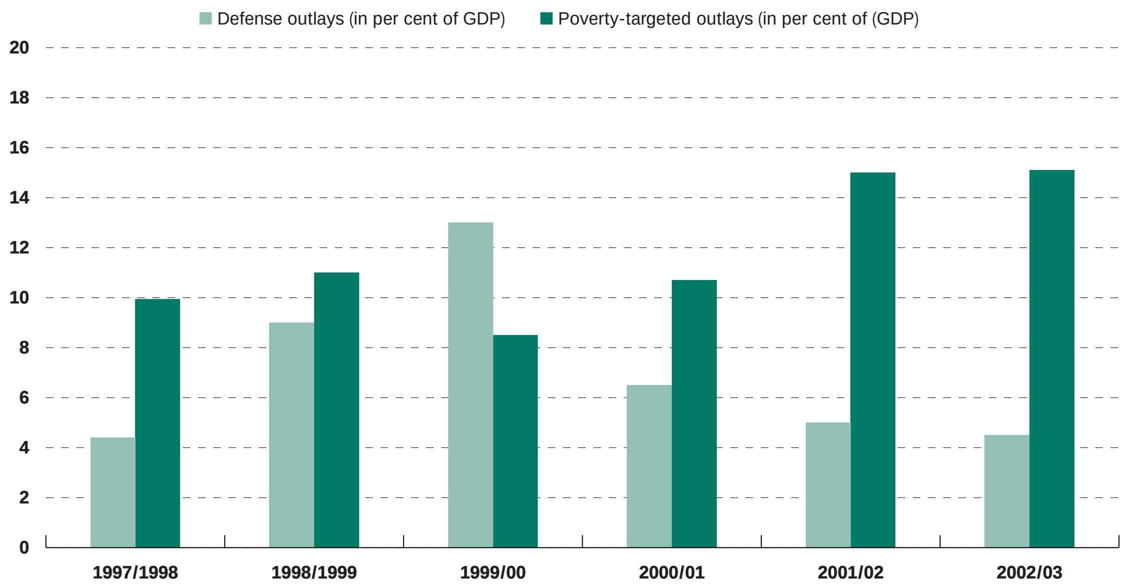
Poverty and poverty-related issues are most crucial in Ethiopia, as the country remains one of the poorest countries in the world. The extreme poverty is exacerbated by a high level of vulnerability and the large variance in levels of essential food consumption. For most of the poor in Ethiopia, food security, even in times of good weather, is a source of anxiety as Ethiopia has a persistence of structural food insecurity that affects 2-3 million mostly poor people every year. This is frequently exacerbated by severe drought conditions. The government has put the reduction of poverty at the centre of its medium-term growth strategy, as outlined in the country's full PRSP that has been prepared through a wide-ranging consultative process. The draft of the PRSP was issued to development partners for comment in July 2002. The final PRSP is expected to be finalised by December 2002. The draft PRSP directly targets the poor and the vulnerable by focusing development on agriculture as the sector, which is the source of livelihood for 85 per cent of the population and the development of which will provide food security for Ethiopians. The draft PRSP has as its overriding objective poverty reduction though at the same time maintaining macroeconomic stability. The government has set itself the target of reducing the poverty headcount ratio by about 10 per cent (about 4 percentage points) from the 1999/00 level of 44 per cent.

In the health sector, the government's recent targeting of poverty-related expenditures has been reflected in real per capita expenditure. Real per capita expenditure, which had declined by nearly a quarter between 1998/99 and 1999/00, rose by nearly 50 per cent in 2000/01. However, given the low expenditure levels of the past, it is obvious that reversing past trends in the sector is a long-term situation. Currently, health coverage is limited to only about 46 per cent of the population. There are about four physicians per 100 000 people; access to safe water is limited to 24 per cent of the population, while access to sanitation is limited to 15 per cent of the population. There are also the problems of inadequate facilities and equipment: those available are often in a state of disrepair, and there is a shortage of essential drugs. The government's health strategy is focused on a Health Extension Package (HEP), a community-based health delivery system aimed at creating a healthy environment as well as healthy living. The main objective of HEP is to improve access and equity through community health services with strong focus on sustained preventive health actions and increased health awareness. The implementation of HEP is due to start in 2002/03. Also, combating the spread of HIV/AIDS, with about 10.6 per cent of the adult population being HIV positive, is a major challenge. To combat this pandemic, Ethiopia has developed a National Response Strategic Framework to HIV/AIDS, covering the period 2002-2004, aiming to reduce the level of HIV transmission by 25 per cent in five years. Also, a multi-sectoral HIV/AIDS programme is under implementation and the government is directly funding NGOs and Civil Society Organisations (CSOs) involved in HIV/AIDS-related activities on a matching grant basis. HIV/AIDS

Councils have also been established at the federal, regional and district levels to monitor programme implementation.

In the education sector, real per capita expenditure has also risen sharply as a result of the government's recent targeting of poverty-related expenditure. Real per capita expenditure that declined by about 6 per cent between 1998/99 and 1999/00, rose by about 30 per cent in 2000/01. There has been a significant improvement in primary school enrolment over the past four years. The recent review of the Education Sector Development Programme in February 2001 revealed that gross primary school enrolment improved to 51 per cent in 2000 compared with 42.9 per cent in 1996; net primary school enrolment ratio for girls increased from 21.5 per cent in 1996 to 36.6 per cent in 1999, while for boys the increase was from 32.3 to 51.2 per cent. However, the education system continues to be characterised by both quantitative and qualitative limitations including shortage of classrooms, teachers, essential textbooks and other learning materials, poor curriculum, and high repetition and drop-out rates, especially among girls. In general, only about 50 per cent of all pupils who enrol in primary schools successfully complete the full cycle. In the draft PSRP, the government's education objective is to ensure access to elementary education for all citizens along with improving quality and relevance of education to socio-economic development. Towards this end, the government is committed within the PSRP to achieving a gross enrolment ratio of 65 per cent with regard to primary enrolment by 2004/05.

Figure 6 - Reduction in Defence Spending is Contributing to Poverty Alleviation



Source: Authors' estimates based on domestic authorities' data.