

Ethiopia: Fourth Review and Third Annual Program Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Extension of Arrangement and for Additional Interim Assistance Under the Enhanced HIPC Initiative—Staff Report; and Press Release on the Executive Board Discussion

In the context of the fourth review and third annual program under the three-year arrangement under the Poverty Reduction and Growth Facility and requests for extension of arrangement and for additional interim assistance under the Enhanced HIPC Initiative, the following documents have been released and are included in this package:

- the staff report for the fourth review and third annual program under the three-year arrangement under the Poverty Reduction and Growth Facility and requests for extension of arrangement and for additional interim assistance under the Enhanced HIPC Initiative, prepared by a staff team of the IMF, following discussions that ended on **July 3, 2003**, with the officials of Ethiopia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 22, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the views of **the Executive Board as expressed during its August 27, 2003 discussion** of the staff report that completed the review.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Ethiopia*
Memorandum of Economic and Financial Policies by the authorities of Ethiopia*
Technical Memorandum of Understanding*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

ETHIOPIA

Fourth Review and Third Annual Program Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Requests for Extension of Arrangement and for Additional Interim Assistance Under the Enhanced HIPC Initiative

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by Anupam Basu and G. Russell Kincaid

July 22, 2003

- Discussions on the fourth review and the third annual program, supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) were held in Addis Ababa during May 26-June 9, 2003, continued in Washington during June 26-27, 2003, and concluded in Addis Ababa on July 2-3.
- The arrangement, in an amount of SDR 86.91 million (65 percent of quota), was approved on March 22, 2001. On the occasion of the second review on March 18, 2002, this amount was augmented by SDR 13.37 million (10 percent of quota) to mitigate the impact on the balance of payments of the continued deterioration of the terms of trade and the events of September 11, 2001.
- The Ethiopian representatives included Mr. Sufian Ahmed, Minister of Finance and Economic Development; Mr. Teklewold Atnafu, Governor of the National Bank of Ethiopia; Mr. Newai Gebre-Ab, Chief Economic Advisor to the Prime Minister; other ministers in charge of economic and social affairs; and other senior government officials. The mission also met with the Prime Minister, Mr. Meles Zenawi, as well as parliamentarians, and representatives of the private sector, bankers, nongovernmental organizations, and donors.
- The staff team consisted of Mr. Tahari (head), Mr. Rwegasira, Mr. Kyei (the Fund's Resident Representative), Mr. Powell, Ms. Strauss, and Mr. Yamauchi (all AFR), Mr. Gilmour (PDR), and Ms. Rondon (Assistant-AFR). Mr. Milton, Advisor to the Executive Director for Ethiopia, and World Bank staff participated in part of the discussions.

	Page
Executive Summary	4
I. Introduction.....	5
II. Performance Under the Second Annual Program and Recent Economic Developments	6
III. Report on the Discussions and the Third Annual Program.....	11
A. Aligning the PRSP, the PRGF Arrangement, and the Annual Budget	12
B. The Program for 2003/04.....	14
Macroeconomic objectives	14
Fiscal policy	15
Monetary and financial sector issues	17
External sector and balance of payments outlook.....	19
Social policies, PRSP, and HIPC Initiative	20
Other structural reforms.....	21
Statistical issues	25
PRGF arrangement monitoring.....	25
IV. Staff Appraisal	25
 Text Boxes	
1. Impact of the 2002/03 Drought.....	7
2. Audit of the Commercial Bank of Ethiopia (CBE).....	9
3. Sources of Growth	13
4. Public Expenditure Management and Fiscal Decentralization	18
5. Triggers for Floating Completion Point Under the Enhanced HIPC Initiative	22
6. Structural Conditionality.....	24
 Figures	
1. Selected Economic Indicators, 1999/2000-2005/06	28
2. Exchange Rate Developments	30
 Tables	
1. Schedule of Disbursements and Repayments Under the PRGF Arrangement, 2003-04	31

2.	Proposed Schedule of Remaining Disbursements and Conditions for Disbursement Under the PRGF Arrangement, 2003-04	32
3.	Selected Economic and Financial Indicators, 2000/01-2005/06.....	33
4.	Central Government Operations, 2000/01-2005/06 (In millions of birr)	34
5.	Central Government Operations, 2000/01-2005/06 (In percentage of GDP)	35
6.	Monetary Survey, 2000/01-2005/06	36
7.	Balance of Payments, 2000/01-2005/06	37
8.	Projected Payments to the Fund, 2002/03-2012/13	38
9.	Social Indicators.....	39

Appendices

I.	Letter of Intent	40
	Attachment I. Memorandum on Economic and Financial Policies for the Period July 8, 2003-July 7, 2004	42
	Table 1. Quantitative Benchmarks and Performance Criteria for the Second Annual Program Supported by the PRGF Arrangement, July 7, 2001-March 2003	54
	Table 2. Structural Benchmarks and Performance Criteria Under the Second Annual Program Supported by the Three-Year PRGF Arrangement	55
	Table 3. Quantitative Benchmarks and Performance Criteria for the Third Annual Program Supported by the PRGF Arrangement, March 2003-March 2004	56
	Table 4. Prior Actions and Structural Benchmarks and Performance Criteria Under the Third Annual Program Supported By the Three-Year PRGF Arrangement	57
	Attachment II. Technical Memorandum of Understanding	58
II.	Relations with the Fund	65
III.	Relations with the World Bank.....	68
IV.	Statistical Issues	71

EXECUTIVE SUMMARY

Recent economic developments have been severely affected by the drought, which is the worst since 1984/85. Real GDP in 2002/03 (July-June) is estimated to have declined by 3.8 percent, while inflation accelerated to 14 percent in 2002/03, from -7.2 percent in 2001/02, mainly because of food shortages. An estimated 12.6 million people are in need of food assistance, and the timely arrival of pledged food aid is critical to ensure food security. The authorities are focusing on long-lasting structural measures to ensure food security in future.

All the quantitative performance criteria and benchmarks through December 2002, as well as the indicative targets for end-March 2003 were observed. All structural performance criteria and most structural benchmarks were also met. The ongoing decentralization of fiscal powers to *woredas* (districts), however, has contributed to delays in the implementation of the two structural benchmarks related to the improvement of public expenditure management.

The program for 2003/04 projects real GDP growth of 6.7 percent, spurred by an agricultural recovery following a two-year decline. Consumer price inflation is projected to decline to 5.5 percent in 2003/04, as food supply conditions return to a more normal level. The external current account deficit is projected to increase to 6.7 percent of GDP. The overall fiscal deficit (including grants, and special program spending equivalent to 1 percent of GDP), will be reduced from 8.5 percent of GDP in 2002/03 to 7.5 percent in 2003/04.

A key element of the program involves pursuing financial sector reform and developing a restructuring plan for the state-owned Commercial Bank of Ethiopia (CBE) by end-November 2003. The plan will set out a clear time frame for reducing nonperforming loans of the CBE to 20 percent of all loans and raising the capital adequacy ratio of the CBE to 10 percent by June 2004. The staff has encouraged the authorities to allow a greater role for the private sector and the entry of foreign banks to the banking sector. The authorities, however, have reiterated their long-held position that they are not ready to take such measures and that they consider that priority should instead be given to strengthening the financial sector and enhancing the supervisory capacity of the central bank.

The staff assessment stresses that sustained higher real GDP growth rates will be achievable only if the pace of structural reforms is accelerated, financial sector reform deepened, and the climate for private domestic and foreign investment greatly enhanced to contribute to job and income creation. A prudent domestic and external debt management strategy will also need to be followed.

It is envisaged that **the next (fifth) review of the PRGF arrangement** will be based on quantitative performance criteria (PCs) at end-September 2003 and structural PCs through November. Based on that review and the satisfactory implementation of the floating triggers, **the completion point under the enhanced HIPC Initiative could be reached by early-2004.**

I. INTRODUCTION

1. The attached letter from the Minister of Finance and Economic Development of Ethiopia and the Governor of the National Bank of Ethiopia (NBE), and the annexed memorandum on economic and financial policies (MEFP), dated July 22, 2003 (Appendix I, Attachment I), review recent economic developments and progress made under the second annual program (October 2001-September 2002) and through March 2003, and set out the policies and measures to be implemented by the government during the third annual program (July 8, 2003-July 7, 2004).

2. **The delay in completing a financial audit of the Commercial Bank of Ethiopia (CBE), originally scheduled for January 2003 (structural benchmark), which was only finalized in early May 2003, has delayed the preparation of the CBE's financial restructuring plan.** Reaching an understanding on key elements of this plan and its subsequent implementation are to be a main component of the third annual program under the Poverty Reduction and Growth Facility (PRGF). Thus, although policy performance under the first and second annual programs under the PRGF was broadly satisfactory except in the financial sector, discussions on the fourth review and third annual program were delayed by six months.¹ The delay necessitates a rephrasing of the third annual program (July 8, 2003-July 7, 2004), bringing the program in line with the Ethiopian fiscal year, a key objective of Ethiopia's poverty reduction strategy paper (PRSP). The fifth review will now be based on economic performance at end-September 2003, and the sixth review will take place six months thereafter. This requires an extension of the three-year PRGF arrangement to end-July 2004, which is requested by the government in the attached letter of intent.

3. In September 2002, the Board concluded the third review under the PRGF arrangement.² Executive Directors welcomed Ethiopia's satisfactory economic performance under the PRGF-supported program. They stressed the importance of maintaining a prudent expenditure policy to limit any recourse to bank financing, and of steadfastly implementing tax reforms. Executive Directors welcomed the actions intended to make the CBE more efficient, and underlined the importance of preparing a financial restructuring plan based on the results of a financial audit.

¹ The delay made it impossible to reach understandings on performance criteria and benchmarks for the second half of 2002/03, as initially envisaged under the program. Availability of the fifth disbursement (SDR 10.43 million), based on end-September 2002 performance criteria, is contingent on the completion of the fourth review and agreement on the third annual program (Tables 1 and 2). Ethiopia's outstanding use of Fund resources amounted to SDR 100.4 million (75.1 percent of quota) on May 31, 2003.

² The last Article IV consultation was also concluded in September 2002. The next consultation will be held within the 24-month cycle in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002 and is expected to take place at the same time as the final PRGF review, before end-July 2004.

4. The Executive Boards of IDA and the Fund decided on November 6 and 8, 2001, respectively, that Ethiopia had reached the decision point under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative). They considered on September 19 and 23, 2002, respectively, that Ethiopia's PRSP provided a sound basis for World Bank and Fund concessional assistance.³ Originally expected in July 2003, the HIPC Initiative completion point is now likely to be reached in early 2004, as more time is needed to meet various triggers. The Ethiopian authorities therefore are requesting additional interim assistance (SDR 2.111 million) under the HIPC Initiative for the period November 8, 2003-May 31, 2004.

5. The World Bank is supporting Ethiopia's reconstruction and reform efforts through emergency programs (US\$428 million over three years) approved in December 2000, and an Economic Structural Adjustment Credit (ESAC—for US\$120 million) approved in June 2002. The World Bank also approved recently a US\$60 million grant to finance food and emergency aid. **The IDA Executive Board discussed a new three-year Country Assistance Strategy (CAS) for 2002/03-2004/05 on April 17, 2003.** The baseline scenario under the CAS envisages disbursements of up to US\$1.5 billion over a three-year period. However, this is conditional on the need to maintain Ethiopia's debt at a sustainable level over the medium term. The IDA Executive Board agreed, therefore, to restrain new lending until after the enhanced HIPC Initiative completion point had been reached, in order to ensure that IDA's projected financing program was consistent with continued debt sustainability. In the meantime, IDA will only disburse new grants in addition to already committed loans. The World Bank and the authorities are discussing the modalities of a Poverty Reduction Support Credit (PRSC—US\$150 million) to be provided as a grant, which is expected to be finalized in the fourth quarter of 2003.

II. PERFORMANCE UNDER THE SECOND ANNUAL PROGRAM AND RECENT ECONOMIC DEVELOPMENTS⁴

6. **Recent economic developments have been adversely affected by the severe drought** (Box 1). Real GDP growth in 2001/02 was revised downward by the authorities to 1.2 percent from 5 percent (Table 3 and Figure 1), reflecting the decline in agriculture production. Real GDP in 2002/03 is estimated to have declined by 3.8 percent, mainly as a result of a 12 percent drop in agricultural production. Inflation accelerated to 14 percent in

³ Ethiopia's PRSP, or Sustainable Development and Poverty Reduction Program (SDPRP), was submitted to the Fund and IDA on August 15, 2002.

⁴ For details on performance under the first annual program, see EBS/02/37 (3/4/02) and EBS/02/158 (8/21/02).

Box 1. Ethiopia: Impact of the 2002/03 Drought

As a result of the failure and/or delays in rains, the food security situation has deteriorated considerably in 2002/03 and is the worst since the 1984/85 drought. The government now estimates that out of a total population of around 67 million people, 12.6 million people require food assistance in 2003. Out of a total food aid requirement of 1.54 million MT for 2003, the amount pledged by donors as of end-May was 1.34 million MT, which is estimated to cover the need through August 2003, while leaving an unmet requirement of 0.21 million MT.

Macroeconomic impact of the drought is severe. Agricultural production in 2002/03 is estimated to have declined by 12 percent from the previous year. Cereal production was most substantially affected, declining by 26 percent, while coffee and livestock production fell by 8 and 6 percent, respectively. Electricity cuts due to water shortages in power generation are also reported. Overall consumer price inflation is estimated to have reached 14 percent in 2002/03, a sharp reversal from the negative inflation in the previous two years. The dominant factor is the food shortage-related sharp increase in cereal prices, which rose by 35 percent in April 2003 (12-month average compared with the previous year). However, the core inflation, excluding cereal price movements, has been relatively stable at around 3 percent.

Despite a major effort by the government and donors, food distribution has been insufficient to meet requirements. The authorities are monitoring the food situation on a daily basis and closely coordinating with UN agencies, other bilateral and multilateral donors, and NGOs. While donor responses have been generally positive, their food arrivals have been delayed and insufficient partly as a result of security concerns in the region due to the war in Iraq and related increases in transportation and insurance costs. In response to the insufficient food for distribution, the government procured locally 47,600MT of foodstuffs for distribution in 2002/03 from food-surplus regions and has reduced the food ration from 15 kg/month to 12.5 kg/month, except for the flood-affected south region, to reach as many of the needy as possible. Timely arrival of pledged food aid is therefore critical to ensuring food security for the coming months.

The government is committed to taking decisive remedial actions for short and medium-term food security. In the short-term, the government will allocate in the 2003/04 budget a total Birr 1.2 billion for a water harvesting scheme, local food purchases (100,000MT), and resettlement program. In the water harvesting scheme, approximately 200,000 households will benefit from water catchment and storage facilities supplied by the government, which will contribute to creating a stable income source from horticultural production. In the medium-term, the government intends to develop irrigation systems, promote off-farm economic activities and technological improvement in agricultural production, and continue the resettlement program. Regarding resettlement, careful designing is essential to avoid social and economic disturbances to settlers. The government is providing basic needs for settlers to start a new life, including food, oxen and seeds, and health and school facilities.

2002/03, from -7.2 percent in 2001/02, mainly because of food shortages.⁵ The external current account deficit (including official transfers) is estimated to have remained at about 6 percent of GDP in 2002/03 (excluding official transfers, the deficit increased from 13.2 percent to 15.2 percent). Coffee exports (which accounted for 37 percent of merchandise exports in 2001/02) continued to decline as both volume and prices fell. This, however, was more than offset by a robust growth of other merchandise (e.g., chat, gold, and leather and leather products) and nonfactor services exports. Large-scale food aid imports, together with higher oil prices resulted in an estimated increase of total imports of 16.5 percent in 2002/03, higher than programmed.

7. **The prolonged drought that severely hit Ethiopia in 2001/02 and 2002/03 is the worst since 1984/85**, with cereal production declining by about 6 percent in 2001/02 and 26 percent in 2002/03. An estimated 12.6 million people are in need of food assistance, compared with about 5 million in a normal crop year. Food assistance needs for 2003 have been estimated at 1.5 million metric tons of cereals. So far, 1.3 million metric tons have been secured, and the government is seeking additional donor assistance to fill the gap. The timely arrival of pledged food aid is critical to ensure food security.

8. **Under the PRGF-supported program, all the quantitative performance criteria and benchmarks through December 2002, as well as the indicative targets for end-March 2003, were observed (Appendix I, Table 1).** The introduction of the value-added tax (VAT), a structural performance criterion, was carried out on time (Appendix I, Table 2), and a performance contract was signed with the CBE in June 2002 (structural benchmark). While progress was made with the help of Fund technical assistance, the authorities explained that the ongoing decentralization of fiscal powers to *woredas* (districts) had contributed to delays in the implementation of the two structural benchmarks (and HIPC Initiative completion point triggers) related to the improvement of public expenditure management. The audited nonperforming loans (NPLs) of the CBE reached a peak of Br 5.8 billion at end-June 2002⁶ (including cofinanced loans with the Development Bank of Ethiopia (DBE)). According to the CBE, these NPLs have fallen to Br 4.2 billion at end-March 2003, through restructuring, cash collection, the issuing of government bonds, and write-offs. Excluding the cofinanced loans amounting to Br 0.7 billion, which were not included in the definition of the structural benchmark, NPLs were reduced only to Br 3.7 billion at end-September 2002, compared to Br 3.1 billion established as the benchmark. The audit of the CBE by an internationally reputable audit firm, originally scheduled as a structural benchmark for January 2003, was eventually completed by KPMG in May 2003 (Box 2). A contract was also signed in May with the Royal Bank of Scotland to begin providing management consulting services to the CBE for a two-year period, starting from June 9, 2003 (both are prior actions for the completion of the fourth PRGF review).

⁵ The nonfood price index rose by 2 percent in 2002/03.

⁶ The increased level at end-June 2002 includes new NPLs associated with several CBE managers and borrowers who were arrested on corruption charges in early 2002.

Box 2. Audit of the Commercial Bank of Ethiopia (CBE)

An independent audit, carried out according to International Accounting Standards by KPMG, was finalized in May 2003. The audit found that (i) NPLs (including loans cofinanced with the Development Bank of Ethiopia) amounted to Birr 5.8 billion (59 percent of total loans) at end-June 2002; (ii) the losses of CBE, after an adjustment by the auditors (including for impaired-interest income), amounted to Birr 471 million in 2001/02; (iii) the bank was very liquid; (iv) the capital adequacy ratio was at 8.3 percent, higher than the minimum required level of 8 percent; and (v) the recommended level of loan loss provisions against the advances portfolio was Birr 2.4 billion, representing an increase in the provisions held by the bank at end-June 2002 of Birr 273 million. The audit recommended that the NPLs issue be addressed, that actions be taken to restore CBE profitability, and that credit risk and portfolio management be significantly strengthened. The audit report recommended that in the long run, the CBE removes core persistent NPLs from its balance sheet altogether. An asset management company to deal with NPLs was also recommended.

The audit report noted that, based on the capital adequacy ratio, CBE does not need a new injection of capital. However, the capital adequacy ratio is very close to the required limit and internationally accepted standard of 8 percent. Any expansion in risk weighted assets or deterioration of capital position could easily bring the ratio to below the minimum required level and the CBE needs to carefully monitor its capital position. The audit report noted that international banks tend to maintain their capital ratio at 10-14 percent. For CBE to achieve this benchmark it would need to consider ways of improving the balance sheet structure (e.g., removing large NPLs from the balance sheet), and also retain profits (e.g., by limiting the amounts of dividends declared or not declaring any for a couple of years).

The CBE has a number of credit risk exposures that breach NBE's single borrower limit of 25 percent of capital and two exposures that exceed 50 percent of capital; the latter two were of particular concern to the auditors.

The report noted the lack of mechanisms to detect and report early credit problems and made a number of recommendations to address these and other observations, including those related to portfolio management, payments system risk, interest rate risk and asset recovery.

9. **The overall fiscal deficit (including grants and emergency programs) is estimated to have declined** from 9.3 percent of GDP in 2001/02 to 8.5 percent in 2002/03, compared with 9.7 percent under the program (Table 5). However, excluding grants, the

deficit is estimated to have widened from 14 percent of GDP to 17.4 percent (compared with 14.5 percent under the program), reflecting emergency assistance equivalent to 5.4 percent of GDP received in the form of grants. Total tax revenue rose by 13.5 percent, to the equivalent of 16 percent of GDP in 2002/03. Several tax measures have been implemented recently, including the introduction of the VAT⁷ and the reduction of the average external import tariff from 19½ percent to 17½ percent in January 2003. The maximum tariff has been reduced from 40 percent to 35 percent, and the number of bands from seven to six. Government expenditures (including special programs) and additional spending in the supplementary budget⁸ is estimated to amount to 39 percent of GDP in 2002/03, higher than programmed by 2.7 percentage points, largely reflecting the high level of food aid received. As a percentage of GDP, defense spending was contained at 5.3 percent. Poverty-targeted outlays (excluding food aid) fell slightly short of the program largely because of the delayed disbursement of some external assistance, but they still rose by 32 percent.

10. **Regarding monetary and exchange rate policies, while the financial market remains dominated by the Commercial Bank of Ethiopia (CBE),⁹ the authorities have continued to sterilize excess liquidity and to move toward allowing greater market determination of interest rates and exchange rates.** Reflecting an accumulation of net foreign assets, broad money growth is estimated at 11.3 percent in 2002/03 (compared with 12.4 percent assumed under the program (Table 6)). Credit to the government sector rose by 3.1 percent, in line with the program. Total credit to the nongovernment sector is estimated to have increased by 4.8 percent (compared with 13.7 percent under the program), reflecting weak economic activity and the decision by the CBE to stop lending to borrowers with NPLs. Increased sales of government securities reduced the banks' excess reserves from 24.5 percent of deposits at the end of the fiscal year 1999/2000 to 8.1 percent by end-July 2002, but the ratio rose again to 12.3 percent by end-March 2003, largely because of weak credit demand. Continued excess liquidity in the banking system contributed to depressed yields in the treasury bill market which remains narrow and shallow. The average weighted yield for three-month bills declined to 1.25 percent during July 2002-March 2003 from 2.04 percent during the same period in 2001/02. Meanwhile, the interest rate structure of commercial banks remained unchanged within the range of 3-13 percent.

⁷ At the time of the introduction of the VAT, the data base on VAT taxpayers was only partially computerized.

⁸ The government adopted a supplementary budget for 2002/03 in May 2003 to take account of additional external assistance in the form of grants from a bilateral donor and some additional nontax revenue, leading to higher spending of around 1.1 percent of GDP, mainly on a project aimed at extending access to education through the use of satellite technology.

⁹ The CBE's share in total deposits and loans was 80 percent and 63 percent, respectively, at end-2002.

11. **The authorities continued to implement reforms aimed at strengthening the CBE and improving the soundness of the financial sector, albeit with significant delays.** The measures included (a) adopting a directive for the provisioning by banks for NPLs and troubled debt in line with international best practices in August 2002 (to be fully implemented by January 2004); (b) signing a performance contract with the CBE to ensure that the CBE is operated effectively on a commercial basis; and (c) allowing private banks to enter into management contracts with foreign institutions (a HIPC Initiative completion point trigger).

12. During the period July 2002-April 2003, the value of the birr has fallen by about 7.8 percent in nominal effective terms (Figure 2). With the consumer price index (CPI) rising steeply as a result of higher food prices, the real effective exchange rate reversed its path of steady depreciation. However, with core inflation¹⁰ estimated at around 3 percent, this is not thought to have had an impact on export competitiveness as evidenced by the sustained volume growth in exports in 2002/03, despite the price related decline in coffee export volumes. At end-March 2003, net foreign assets of the National Bank of Ethiopia (NBE) were estimated at US\$730 million (around 3.6 months of imports of goods and services) compared with the programmed level of US\$521 million. Gross foreign reserves were estimated at about 4.6 months of import cover.

13. In other **structural areas** of the program, progress was made, with World Bank assistance, in implementing reforms focused on public sector management, including civil service reform and public expenditure policy, and on private sector development. Several small public entities largely in the services sector were brought to the point of sale in 2002, but the sale of larger public entities has proved more difficult.

14. **On the political front**, the Eritrean and Ethiopian authorities are discussing with the United Nations Mission to Eritrea and Ethiopia (UNMEE) the issue of the border demarcation between the two countries.¹¹

III. REPORT ON THE DISCUSSIONS AND THE THIRD ANNUAL PROGRAM

15. In addition to reviewing program implementation, the discussions with the authorities focused on (a) the medium-term policy strategy and alignment of the PRSP and the PRGF; (b) updating the macroeconomic framework and reaching understanding on the 2003/04 budget; (c) reaching an understanding on the key elements of a financial restructuring plan for the CBE; and (d) establishing quantitative and structural performance criteria and benchmarks for the period through January 2004.

¹⁰ Defined as consumer price inflation, excluding cereals and pulses.

¹¹ Ethiopia has demobilized over 142,000 soldiers, or 40 percent of the armed forces.

A. Aligning the PRSP, the PRGF Arrangement, and the Annual Budget

16. Discussions on the third annual PRGF-supported program were carried out in the context of the strategy outlined in the authorities' full PRSP, discussed by the Executive Boards of the IMF and IDA in September 2002¹² (see paragraphs 14 and 15 of the MEFP). **The authorities, fully aware of the critical importance of achieving high real GDP growth to reduce poverty, reiterated their commitment to continue implementing prudent macroeconomic policies and wide-ranging structural reforms.** The strategy therefore continues to stress (a) a budget reallocation from defense outlays to poverty-reducing expenditures; (b) strengthening government revenues; (c) improving public expenditure management in the context of an overall reform of the public service and a decentralization of fiscal powers to the *woredas* (districts); and (d) strengthening the investment climate, the financial sector, and the rural economy. The Executive Boards found that this strategy was comprehensive and that the PRSP could form a basis for concessional assistance by the Fund and IDA. However, while the full PRSP aims at achieving 7 percent annual real GDP growth, in order to ensure fast poverty reduction, this was considered by the staff and the Executive Boards as too ambitious, particularly in light of Ethiopia's high dependence on agriculture and vulnerability to weather conditions (Box 3). They urged that the first annual progress report of the PRSP present alternative scenarios.¹³

17. Taking into account the development strategy outlined in the PRSP and the impact of the recent drought, but assuming a more realistic real GDP growth, **the updated medium-term objectives for 2003/04-2005/06** aim at (a) achieving an annual average real GDP growth rate of over 6 percent;¹⁴ (b) limiting core inflation to a low rate of about 3 percent; and (c) reducing the external current account deficit (including official transfers and excluding aircraft imports of Ethiopian Airlines—see below) to about 4.9 percent of GDP (9.3 percent, excluding official transfers) by 2005/06 (Table 7). In discussing the strategy to achieve the projected 6 percent real GDP growth, or even a higher rate, the staff stressed the need to accelerate the pace of structural reforms, deepen financial sector reform, and greatly enhance the climate for private domestic and foreign investment, in order to contribute to job and income creation.

¹² See EBD/02/130 (8/28/02) and EBD/02/131 (8/28/02).

¹³ The annual progress report is being prepared by the authorities and is expected to be presented to the Boards later this year.

¹⁴ As noted in the joint staff assessment (JSA) of the PRSP, even a target of 6 percent is ambitious, as the outcome is highly dependent on adequate rainfall, favorable external developments, the pursuit of an aggressive reform agenda, and the implementation of sound macroeconomic policies that would promote higher private savings and investment.

Box 3. Ethiopia: Sources of Growth

The economy grew by 5 percent on average over the decade through 2001/02, driven by strong nonagricultural growth. The nonagricultural sector expanded by 8 percent on average, supported by strong service sector growth. While special factors related to the mobilization during the border conflict with Eritrea (1998-2000) caused public administration to expand, robust growth in other subsectors, in particular distribution services, contributed to the service sector growth by 7 percent even without public administration (9 percent with public administration). Following the depressed period during the communist regime in 1980s, industrial sector grew strongly by 7 percent in the last 10 years. As a result of these development, the nonagricultural sector increased its share in total GDP to 57 percent by 2001/02 from 43 percent in 1991/92.

The agricultural sector has suffered from large drought-related fluctuations and has expanded only weakly. Over the period 1991/92-2001/02, the sector grew by 2.5 percent on average, and its share in GDP shrank to 43 percent from 57 percent. The agricultural growth rate ranges from -4 percent to 15 percent, although the rate is expected to have fallen to -12 percent in the drought-affected 2002/03. Such volatility originates from rain-dependent farming with little irrigation or water catchment facilities and leads to chronic food insecurity, with about 5 million people in need of food assistance even in normal crop years, as well as large swings in growth and inflation rates.

Ethiopia relies on agriculture for a large share of merchandise export earnings (80-90 percent), with coffee, chat, oilseeds, pulses and horticultural products the most important products. Total merchandise export volume growth has been relatively strong over the last decade averaging 7.3 percent per annum, although there have been large annual variations due to droughts, the adverse impact of falling export prices, particularly for coffee, and demand instability. Development of new markets and export crops, such as cut flowers, together with the trade and exchange rate reforms of the early 1990's following the downfall of the Derg, have provided the main impetus to merchandise export volume growth. Ethiopia's services export sector, principally based on transportation and related activities, has also grown steadily over the past decade with the establishment of Addis Ababa as a regional capital for international organizations, for conferences and as an airline transportation hub. Such developments have seen total exports of goods and services rise from 5-7 percent of GDP in the early 1990s, to around 16 percent in 2002/03. However, Ethiopia is especially vulnerable to commodity price fluctuations and has suffered from a significant (67 percent) decline in the price for coffee, its largest export earner, over the past five years. This has led to a drop in coffee export volumes from a high of 123,200 tons in 1996/97 to below 100,000 tons in 2000/01 as producers switched to selling coffee domestically, and earnings have fallen from a peak of US\$420 million in 1997/98 to around US\$160 million in 2001/02. This represented 37 percent of total exports, down from 60-70 percent in the mid-1990s. A slow recovery in coffee export prices during 2002/03 together with policy reforms designed to encourage exports, is now prompting a pick up in coffee export volumes. However, prospects remain heavily dependent on future price developments.

Growth accounting estimates indicate the importance of total factor productivity. The economy grew by 3 percent on average over the last 40 years, with physical and human capital contributing to growth by 2 percent each, while total factor productivity contributed negatively by -1 percent. However, economic reforms and liberalization have raised total factor productivity to 1 percent out of overall growth of 5 percent over the past decade, which represents a sharp contrast to the former communist Derg regime (1972/73-1991/92) where total factor productivity made -3 percent contribution to the total 1 percent growth. Continued improvement in total factor productivity and policy reforms as envisaged under the PRSP suggests the overall growth rate around 6 percent over the medium-term is feasible, mostly consistent with the required growth rate of 5.7 percent to achieve a Millennium Development Goal.

18. **Over the medium term, based on presently identified external assistance, the overall fiscal deficit is projected to be reduced** from 8.5 percent of GDP in 2002/03 to 3.9 percent by 2005/06. Tax revenues are projected to increase from 16 percent of GDP in 2002/03 to 17.6 percent by 2005/06, largely as a result of the tax reform measures being implemented. Reflecting a prudent spending policy and the focus on poverty-reducing spending, total outlays would be reduced to 30.5 percent of GDP, with defense spending falling to 3.9 percent, poverty-related outlays continuing to increase to 18.2 percent, and the wage bill contained at about 7.8 percent through 2005/06.

B. The Program for 2003/04

Macroeconomic objectives

19. **The mission and the authorities updated the macroeconomic framework for 2003/04 and the medium-term in light of recent developments and the latest world economic outlook (WEO) price projections.** The program for 2003/04 projects real GDP growth of 6.7 percent, spurred by an agricultural recovery following a two-year decline caused by the prolonged drought. Major capacity building and infrastructure expansion, the acceleration of the privatization program for public enterprises, and further progress in financial sector reform should create an environment conducive to private investment, thereby contributing to an increase in private investment to 9.8 percent of GDP. As food supply conditions return to a more normal level, consumer price inflation is projected to decline to an average of 5.5 percent in 2003/04, with core inflation remaining at around 3 percent. The external current account deficit (including official transfers and excluding aircraft imports for Ethiopian Airlines (EAL)¹⁵) is projected to increase to 6.7 percent of GDP, as a further rise in import prices is offset by a modest recovery in export prices. The import reserve cover is to increase from 3.3 months of imports at the end of 2001/02 to 4.5 months at end-June 2004 (including EAL imports).

¹⁵ As part of the fleet expansion program, EAL will lease 12 new planes over the next 3 years. The planes will be delivered in three tranches, starting in November 2003, July 2004, and July 2005, and will be financed by a \$350 million commercial loan to be repaid over 12 years. Under the PRGF arrangement, the long-term financing operations of EAL are excluded from the program limit on new nonconcessional external debt contracted or guaranteed by the public sector. This exemption has been included in all Fund-supported programs with Ethiopia since the early 1980s on the grounds that EAL is a profitably run autonomous entity and large earner of foreign exchange that borrows without a government guarantee. However, the debt of EAL was included in the HIPC DSA for the decision point. Based on present HIPC policies, debt of the EAL would be included in the DSA for the completion point.

Fiscal policy

20. **The fiscal strategy is focused on achieving and maintaining public debt sustainability, and maximizing the efficient use of highly concessional resources for poverty reduction-related activities.** Discussions with the authorities centered on three key issues: the need to enhance revenue performance, the importance of pursuing a prudent public expenditure management while continuing to reorient spending to poverty reduction, and the need to limit bank financing of the fiscal deficit. The overall fiscal deficit (including grants, and special program spending equivalent to 1 percent of GDP), as reflected in the approved budget for 2003/04, will be reduced from 8.5 percent of GDP in 2002/03 to 7.5 percent 2003/04.¹⁶ This deficit will be covered by already approved external financing (entirely on concessional terms or in the form of grants),¹⁷ and through Br 1 billion (1.6 percent of GDP) in domestic borrowing from the banking system. Such domestic borrowing intentions were identified in the PRSP and are deemed necessary to help finance the drought-related increase in food security expenditures during 2003/04 (shown in capital spending), involving public investment in water harvesting schemes and to support the voluntary resettlement of populations to less drought prone lands. Although already high, at an estimated 37.5 percent of GDP¹⁸ (Table 3), such an increase in domestic debt is viewed as manageable as long as public spending continues to foster a more rapid increase in GDP growth. With liquidity in the banking system high, there is also little risk of crowding out the private sector.

21. Nonetheless, **the staff urged the authorities to seek donor support, preferably grants, for the planned food security spending program** in order to limit the overall recourse to domestic borrowing. The authorities agreed and, given the urgency of the situation and the relatively high level of foreign exchange reserves, consideration would be given to drawing on these reserves to finance critical food imports if donor pledges were insufficient to close the food gap. Gross foreign reserves are currently about \$100 million higher than initially targeted under the program and are projected to increase further during 2003/04, even with the increase in imports stemming from spending on food security.

¹⁶ If higher than currently assumed IDA loan disbursements are eventually committed, and provided debt sustainability is not jeopardized, the overall deficit in 2003/04 and over the medium term would be higher by up to 1 percent of GDP as anticipated at the time of the third review, and noted in the last staff report (EBS/02/158).

¹⁷ Identified grant financing (8.5 percent of GDP) for 2003/04 includes a PRSC grant of \$150 million from IDA, as well as about \$75 million in budget support from the EU and bilateral donors.

¹⁸ The primary balance after debt relief is projected to be -6.2 percent of GDP in 2002/03 and -5.3 percent in 2003/04.

22. **To achieve the tax revenue target of 16.5 percent of GDP in 2003/04**, revenue performance will benefit from the full-year impact of the VAT introduced in January 2003, and from improved tax administration, especially the strengthening of the large taxpayer unit. Measures are being taken to collect tax arrears and to pursue the implementation of the tax reform program, in particular the computerization of the tax identification number and of the VAT, as well as an assessment of customs administration with the support of technical assistance from the Fund.

23. **Regarding expenditures**, total outlays (including special programs and food emergency assistance) are targeted to decline to 36.7 percent of GDP in 2003/04. Externally financed food aid is projected to decline to 1.4 percent of GDP. In addition, domestically-financed outlays amounting to Br 1.2 billion (1.8 percent of GDP) will be allocated for a voluntary resettlement program, water harvesting schemes, and local food purchases. Other poverty-targeted spending is to increase to 17.9 percent of GDP (including 1.3 percent from HIPC relief). Defense outlays are to be cut by 0.5 percentage points of GDP to 4.8 percent. The total wage bill is to be limited to 7.8 percent of GDP. Capital outlays are projected at 14.7 percent of GDP, which is higher than originally programmed, reflecting in part the additional domestically financed food security spending. Externally financed capital spending projections are based only on existing loan commitments from the World Bank. Regarding future disbursements from the World Bank, in line with the Country Assistance Strategy (CAS), at this stage the authorities included in the budget only grants shown in IDA's CAS for 2003/04, in addition to disbursements from previously committed IDA loans. At the time of the HIPC Initiative completion point, Ethiopia's debt sustainability will be reassessed and the amount of any possible topping up will be determined. At that time, any additional secured commitment of IDA loans will be added in a supplementary budget provided that disbursements will be spent efficiently on poverty-related sectors and will not jeopardize debt sustainability. Any additional HIPC Initiative assistance granted at the time of the completion point will also be included in the supplementary budget.

24. **Efforts to strengthen the budget management program will continue** (paragraph 20 of the MEFP). In particular, as a performance criterion for end-November 2003, the consolidation of federal and regional budgets for both the past budget year and the current budget year—including all extrabudgetary funds and accounts—will be carried out.¹⁹ Moreover, efforts will be pursued to improve the effectiveness, reporting, and monitoring of local governments' expenditures, and address outstanding issues related to the decentralization of fiscal powers outlined in recent FAD technical assistance missions, particularly to ensure that (i) regional institution's budget laws, and regulations contain clear delineations of expenditure and revenue assignments; (ii) fiscal reporting from *woredas*

¹⁹ This measure was originally a structural benchmark for end-September 2002. The completion point trigger, however, specifies that this consolidation should take place prior to the budget year, which is no longer feasible because of the difficulties encountered at the district level.

(districts) is adequate, identifying the cost of decentralization and of *woredas*' new employment structure; and (iii) the transparent responsibilities for capital and poverty-reducing spending at regional and *woreda* level are clearly delineated (Box 4).

Monetary and financial sector issues

25. **The monetary program for 2003/04 was updated with a view to achieving the inflation and international reserve targets under the program.** To help achieve these targets while providing room for an adequate increase in credit to the nongovernment sector, the government will limit its borrowing from the banking sector to the above-mentioned Br 1 billion. The inflationary and balance of payment impact of this borrowing would be limited, because of its limited impact on demand pressure and the low import content of the spending it would finance. Money supply is projected to rise by 13.4 percent in 2003/04 slightly higher than nominal GDP. Interest rate policy will remain under review. All interest rates are market determined, with the exception of the minimum saving deposit rate, set at 3 percent. With the consumer price index projected to decline to an average of 5.5 percent in 2003/04 (mainly reflecting a fall in food prices) and with core inflation expected to hold at about 3 percent, current interest rates remain appropriate with rates for time deposits in the range 3.3-3.7 percent and lending rates between 7.5-13 percent. The exchange rate will continue to be market determined and the effectiveness of the newly established interbank foreign exchange market will be strengthened.

26. **In the financial sector, discussions focused on how best to address the difficulties faced by the CBE, strengthen the financial sector, and promote competition in the sector.**²⁰ While agreement was reached on several elements, there was still a difference of views between the authorities and staff on some key reforms relating in particular to the dominance of the CBE and competitiveness. As presented in paragraph 22 of the MEFP, several measures are being implemented including in particular the full provisioning by banks for nonperforming loans and other doubtful assets in line with international best practices by January 2004 (set as a structural benchmark; it is also a completion point trigger under the enhanced HIPC Initiative); and strengthening the NBE, following the completion of the ongoing comprehensive study of the NBE, including as necessary, revising the existing Banking Act to increase the NBE's autonomy by end-2003.

27. **To restore the CBE's profitability and ensure that it becomes a sound and profitable bank, the authorities will finalize, adopt, and commence implementing by end-November 2003 a detailed financial restructuring plan.** However, while the staff continued to urge that the CBE be split into a number of smaller viable entities, or its capital opened to private sector ownership, the authorities reiterated their position that the first

²⁰ Fund staff is working very closely with the World Bank staff in advising on these reforms.

Box 4. Ethiopia: Public Expenditure Management and Fiscal Decentralization

In early 2002, the Ethiopian authorities committed to push fiscal decentralization to the district (woreda) level. This process has been implemented very rapidly. By July 2002 (the beginning of the Ethiopian fiscal year), the four largest regions (Tigray, Amhara, Southern Nations Nationalities and People's Region (SNNPR), and Oromiya) decentralized fiscal powers to the woreda councils. This box outlines a number of the challenges that have arisen in implementation.

The woreda decentralization has the potential to better match the composition of spending to local needs. Over the longer term, the system should also allow for the same degree of macrofiscal control (including over the composition of spending) as the pre-decentralization model. However, the federal government has a critical role to play in guiding the regions in the implementation of decentralization. The design of the decentralizing strategy—and the measures implemented at the regional level to ensure a smooth transition to the new system—need to be closely monitored to ensure that these important policy objectives are achieved.

The woredas' new discretion in setting expenditure priorities leaves federal and regional governments with less formal control of the composition of general government spending. There is a need, therefore, for measures to be implemented to ensure that adequate macrofiscal control can be applied within the decentralized fiscal system. Measures will address the need to ensure that woredas continue to meet national targets for poverty-reducing expenditure without unduly restricting their ability to alter expenditure priorities to meet local needs, and could include, for example, minimum floors on the share of poverty reducing spending.

Moving immediately to providing a formula-determined block grant to the woredas, without formal transition provisions, has proved difficult. As the formula used does not take into account existing expenditure responsibilities, it has left some woredas with a deficit they cannot cover, and others with a surplus they cannot implement. As a result, regions have been forced to implement ad hoc and nontransparent readjustments to ensure service delivery is not unduly affected. As the formula used is similar to that used by the federal level, it replicates some of its shortcomings, including creating a disincentive for revenue collection.

The pressure to implement the woreda decentralization has also placed further strain on the public expenditure management system and its ability to track poverty-reducing spending. Fiscal reporting, which was already subject to considerable delay, has in some regions further lagged, endangering efforts to report on consolidated budget outturns (and submission of new budgets) at the regional level. In principle, however, the implementation of the new system should not diminish the ability of the system to provide consolidated reports adequate for the tracking of poverty-reducing expenditure.

Finally, the additional administrative requirements and staffing needs of the new system have also put additional pressure on the system. Woredas have found it difficult to fill all these positions because of the lack of suitably qualified individuals and available budget. Further pressure on available fiscal resources came from the full-year effect of a federally-mandated pay increase in January 2002. It will be important to ensure that when vacant positions are filled, the capital, operations, and maintenance expenditures that have the most tangible effect on poverty reduction are fully protected.

option was not viable (a view shared by the World Bank staff), and that they prefer to maintain the CBE as a publicly owned bank, while addressing all its problems. In doing so, they also wanted to minimize any fiscal cost associated with the restructuring plan, noting that their immediate priority is to use scarce fiscal resources for poverty reducing spending. The staff would have preferred a more accelerated pace for dealing with NPLs and greater private sector representation on the CBE board. The compromise reached between the authorities and the staff is detailed in paragraph 24 of the MEFP. The main features of the agreement are as follows: First, measures are being taken or will be carried out to minimize the risk of new NPLs emerging. The measures that have been implemented include (a) ceasing all lending to borrowers with NPLs; (b) strengthening the credit approval and monitoring process for all new loans; (c) transferring lending authority from the board of the CBE to its management; (d) giving autonomy to management in decision making; (e) creating an audit committee at the board to oversee financial performance; and (f) implementing the revised foreclosure law to speed up its application and improve its effectiveness. Second, as part of the restructuring plan of the CBE, credit risk and portfolio management will be significantly strengthened. Third, the CBE will (a) comply fully with the NBE provisioning directives by January 2004; (b) prepare a timebound plan to reduce NPLs to 20 percent of total loans; (c) ensure that the capital adequacy ratio will not fall below the minimum required ratio of 8 percent, and promptly recapitalize the bank should the ratio fall below 8 percent; and (d) not pay annual dividends until the capital adequacy ratio reaches at least 10 percent, and prepare a business plan to achieve this target by June 2004. Finally, it was agreed that an MFD mission, or preferably a joint MFD/World Bank mission, will go to Ethiopia to discuss the restructuring plan of the CBE when it is ready. An assessment of any fiscal impact of the restructuring plan will be carried out at that time.

28. **Regarding measures to strengthen competition in the banking sector**, the authorities have indicated that they will continue their efforts to enhance efficiency and competition in the financial sector, in order to prepare the ground for the progressive integration of the Ethiopian financial sector into the global financial market. The staff continued to encourage the authorities to allow the entry of foreign banks into the financial sector, initially by allowing foreign minority shareholding in private domestic banks. They, however, reiterated their position that they were not ready to take such measures and consider that priority should first be given to strengthening the financial sector and enhancing the supervisory capacity of the central bank. The staff and the authorities agreed on the importance of fostering the development of microfinance institutions.

External sector and balance of payments outlook

29. **The balance of payments projections for 2003/04 and the medium term were updated**, taking into account the most recent revisions to the WEO, the latest available information on coffee exports, and food relief. A small increase in the external current account deficit (including official transfers but excluding aircraft imports of EAL) to

6.7 percent of GDP is projected for 2003/04.²¹ This will be fully covered by project loan disbursements, balance of payments support from the AfDB (US\$26 million), World Bank balance of payments support grant (US\$150 million), aid for reconstruction and demobilization programs (US\$74 million), and by assistance under the enhanced HIPC Initiative (US\$91 million). Such external financial assistance should allow further accumulation in international reserves to the equivalent of 4.7 months of following year imports (excluding EAL imports). Over the medium term, the current account deficit (including transfers and excluding EAL imports) is expected to decline to 4.9 percent of GDP by 2005/06 (6.3 percent including EAL imports), as a result of the continued growth of nontraditional and traditional exports. At the same time, the growth of total imports is expected to slow, reflecting lower food aid requirements. Sustained concessional lending, together with debt relief under the HIPC Initiative will allow the maintenance of foreign exchange reserves at around 4.6 months of imports.

30. The bilateral agreements following the Paris Club meetings on April 5, 2001 and April 12, 2002 have been signed with all but one Paris Club creditors, and the last one is being finalized. Progress is also being made in bilateral negotiations with non-Paris Club creditors. Staff encouraged the authorities to seek rescheduling of debt owed to non-Paris Club creditors on terms at least comparable to those given by the Paris Club. **The staff team also urged the authorities to formulate and implement a comprehensive debt-management strategy that covers both domestic and external debt.** Repayments to the Fund will remain relatively small in relation to projected exports of good and services, and Ethiopia is expected to meet its future obligations to the Fund in a timely manner (Table 8)

31. **The mission encouraged the authorities to eliminate the few remaining exchange restrictions²² that existed prior to the PRGF arrangement,** and to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. The staff also urged that implementation of the recommendations made in the Safeguards Assessment of the NBE be speeded up.

Social policies, PRSP, and HIPC Initiative

32. **The mission, in collaboration with the World Bank, assessed progress made in implementing the full PRSP.** The authorities are preparing the progress report on the first year of implementation of the PRSP. The staff stressed the importance of including in the report (i) a strategy for promoting private sector development, including agriculture;

²¹ Including EAL's imports, the deficit would widen to 8.3 percentage of GDP in 2003/04.

²² These restrictions relate to (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits.

(ii) alternative macroeconomic scenarios, as well as an examination of the linkages among macroeconomic policies, structural reforms, and poverty; (iii) a refinement of costing of PRSP programs, and (iv) an evaluation of the early experience with fiscal decentralization. Progress is also being made in conducting poverty and social impact analysis, in particular the impact of the introduction of the VAT and of the decline in coffee prices. The progress report is expected to be presented to the Board at the time of the fifth review of the program.

33. **Progress has been made in implementing the trigger measures for reaching the floating completion point under the enhanced HIPC Initiative, although there have been some delays** (Box 5). Satisfactory performance under the third annual program will allow a six-month continuous track record of policy implementation under the PRGF to have been established by end-2003. The value-added tax (VAT) was introduced in January 2003, and the concrete measures for the financial restructuring of the CBE and increasing competition in the financial sector are expected to have been completed by January 2004, when the new directive on provisioning for nonperforming loans becomes fully effective. In the assessment of the World Bank, the triggers on health were already achieved in 2002, and those on HIV/AIDS are expected to be achieved by end-2003. However, the achievement of triggers on agriculture and education are behind schedule. Regarding agriculture, the authorities will implement a series of actions agreed upon with the World Bank and produce half-yearly assessment reports accordingly, while on education the World Bank has indicated that implementation efforts are to be judged on the basis of reassessed targets. The reconciliation of monetary and fiscal accounts is scheduled to be completed by end-December 2003 with a further technical assistance from the Fund, and the authorities have indicated that the consolidation of federal and regional budgets, including all extrabudgetary funds and accounts, is to be completed by end-November 2003, although clearly it would not be until the 2004/05 budget that this could be done at the beginning of the fiscal year.

Other structural reforms

34. Other structural reforms are being implemented in consultation with the World Bank and other donors, including measures relating to agricultural reform, food security, capacity building, civil service, the privatization program, export promotion, and the strengthening of the existing legal and regulatory framework (Box 6). In these reform areas, a number of specific measures are aimed at promoting private sector development. In particular, steps are being taken to reduce the burden of business licensing requirements, reform the investment code to make it more investor-friendly, improve access to land through reform of land leasing, and strengthen the private-public consultation process. **The staff urged that the pace of structural reforms be accelerated, with priority being given to the measures aimed at enhancing the climate for private investment.**

Box 5. Ethiopia: Triggers for Floating Completion Point Under the Enhanced HIPC Initiative

Triggers	Status
<p>PRSP. A full PRSP will have been prepared and implemented satisfactorily for at least one year as evidenced by the joint staff assessment of the country's annual progress report.</p>	<p>A full PRSP was submitted to the Fund and the World Bank on August 15, 2002. On September 19 and 23, 2002, the IDA and Fund Executive Boards, respectively, considered the full PRSP as providing a sound basis for concessional assistance. The first annual progress report is expected this fall.</p>
<p>Macroeconomic stability. Continued maintenance of macroeconomic stability as evidenced by satisfactory implementation of the PRGF-supported program.</p>	<p>The Fund Executive Board concluded the third review under the PRGF arrangement on September 23, 2002. The fourth review is scheduled for July 2003. A six-months track record would need to be established from the completion of the fourth review.</p>
<p>Governance and public expenditure management. The authorities will have strengthened public expenditure management by (i) reconciling monetary and fiscal accounts starting in fiscal-year 2001/02; and (ii) as part of the budget exercise, consolidating federal and regional budgets for both the past year and the budget year—including all extrabudgetary funds and accounts—at the beginning of each fiscal year, starting in 2002/03.</p>	<p>(i) The reconciliation of monetary and fiscal account, originally set as a structural benchmark for September 30, 2002 then revised to December 31, 2002 under the PRGF arrangement, was delayed partly because of the ongoing decentralization process. The reconciliation is a structural benchmark for end-December, 2003 under the third annual program, with a further technical assistance from the Fund; and (ii) the consolidation of federal and regional budgets, set as a structural benchmark for September 30, 2002 under the PRGF arrangement, was delayed as a result of the ongoing decentralization. The consolidation is set as a performance criterion under the third annual program for end-November, 2003. However, consolidation would not be at the beginning of the fiscal year until 2004/05.</p>
<p>Structural reforms and social sectors. In these areas, the authorities will have done the following:</p>	
<p>a. introduced the value-added tax by January 2003;</p>	<p>The value-added tax (VAT) was introduced in January 2003.</p>
<p>b. completed the financial restructuring of the Commercial Bank of Ethiopia (CBE) and increased competitiveness of the financial sector through (i) allowing the management of CBE to operate on commercial principles (including autonomy of decision on staffing, on meeting performance targets set by CBE's Board, and on pursuing delinquent borrowers); (ii) provisioning for nonperforming loans and other doubtful assets in line with international standard practices;^{1/} and (iii) allowing private banks to enter into management contracts with foreign institutions;</p>	<p>(i) A performance contract, set as a structural benchmark for June 30, 2002 under the PRGF arrangement, was signed by the government and the management of CBE on June 28, 2002 to ensure that the CBE is operated effectively, on a commercial basis. The management of CBE now has autonomy in decision making, including staffing, meeting performance targets, and pursuing delinquent borrowers; (ii) a new directive on the amendment of provisions was adopted on August 31, 2002. A first directive was adopted on March 30, but was subsequently revised to bring it more fully in line with international best practice. The directive stipulates that full provisioning should be implemented by January 2004; and (iii) private banks are allowed to enter into management contracts with foreign institutions. However, none of the banks have chosen to do so at this stage.</p>

^{1/} Taking into account Basel Committee guidelines for trouble debt restructuring and credit risk.

Box 5. Ethiopia: Triggers for Floating Completion Point Under the Enhanced HIPC Initiative (concluded)

Trigger	Status
<p>c. agriculture: implemented satisfactorily an action plan agreed with IDA, that aims at improving fertilizer input market competitiveness and efficiency, and that includes monitorable indicators, with half-yearly assessment reports beginning in December 2002;</p>	<p>As agreed in the HIPC decision point document, the IDA staff is responsible for monitoring triggers in agriculture and in the social sectors. A series of actions have been agreed upon which will improve the competitiveness and efficiency of the fertilizer market, including flexible access of foreign exchange for fertilizer imports, withdrawal of the agricultural extension service from input distribution and input credit management, strengthening of farmers' cooperatives to replace regional governments in administering fertilizer credit, and a reduction in the up-front financing requirements for importing fertilizer. Half-yearly assessment reports have not been produced yet</p>
<p>d. education: (i) reduced the repetition rate at the primary level from 9 percent in 1999/00 to 7 percent; and (ii) increased the gross enrollment rate of girls in primary level from 40.7 percent in 1999/2000 to 50 percent;</p>	<p>(i) Progress on the repetition rates has been slower than anticipated at the HIPC decision point. Redefining the target may be necessary, based on the available data; and (ii) there has been some progress on the enrollment rate of girls, from 40.7 percent in 1999/2000 to 41.4 percent in 2001/02.</p>
<p>e. health: (i) increased DPT3 vaccination coverage from 40 percent in 2000/01 to 50 percent; and (ii) increased the utilization rate of health outreach facilities (defined as the number of new outpatients during the year divided by total population) from 27 percent in 2000/01 to 30 percent; and</p>	<p>(i) DPT3 coverage has reached 51.5 percent in 2002, hence achieving the target; and (ii) the health outreach utilization rate is expected to have reached 30 percent in 2002, based on data from regions which have so far reported results. Full national data will be available soon.</p>
<p>f. HIV/AIDS: increased the distribution of condoms throughout the country by 6 million annually, starting from 50 million in 2000.</p>	<p>50 million condoms were distributed in 2000, 57 million in 2001, and 65 million 2/ are planned for 2002. 46 million condoms were distributed during the first nine months of 2002.</p>

2/ This figure includes an estimated annual distribution of 5 million by Pathfinder and Ministry of Health.

Box 6. Ethiopia: Structural Conditionality

Structural conditionality envisaged under the third annual program

Conditionality under the third annual program (Appendix I, Table 4) relates to (a) **restructuring the financial sector, in particular the Commercial Bank of Ethiopia (CBE)**; (b) **improving public expenditure management**, and (c) **enhancing the safeguards of the National Bank of Ethiopia (NBE)**. Structural conditionalities related to the CBE include (i) completing an audit by a reputable international audit firm; (ii) hiring a reputable international management consultant (both prior actions; done), and (iii) finalization and adoption of a financial restructuring plan (performance criterion). An NBE directive requiring full provisioning by all commercial banks for nonperforming loans will become fully effective by January 2004 (structural benchmark). On improving public expenditure management, two structural conditionalities, originally envisaged under the previous annual program, are included: consolidation of federal and regional budgets (performance criterion) and reconciliation of monetary and fiscal accounts (structural benchmark). Finalization of a restructuring plan for the NBE (structural benchmark) is designed to enhance the safeguards of the central bank.

Structural conditionality in the previous second annual program

Conditionality under the second annual program (Appendix I, Table 2) related to (a) restructuring the financial sector, in particular the Commercial Bank of Ethiopia (CBE); (b) enhancing the safeguards of the National Bank of Ethiopia; (c) improving tax administration and revenue; and (d) improving public expenditure management. Most of prior actions, benchmarks, and performance criteria, including the introduction of the VAT, were completed as scheduled, with the exceptions: (i) an audit of the CBE; (ii) reduction of the NPLs of the CBE; (iii) consolidation of federal and regional budgets; and (iv) reconciliation of monetary and fiscal accounts.

Structural reforms supported by the World Bank

The World Bank supported Ethiopia's reform efforts through an **Economic Structural Adjustment Credit** approved in June 2002. Its conditionality concentrated in the following areas:

- private sector development and export competitiveness, including the approval by the Council of Ministers of a draft trade practice proclamation, a draft federal urban land lease proclamation, and a draft revised investment code; the adoption of a directive regulating shipping services, and of a directive regulating the implementation of the bonded manufacturing warehouse scheme; and the preparation of studies on markets for rawhides and skin, and on coffee marketing;
- civil service reform, including approval of the civil service grievance system and procedures by the Council of Ministers, the completion of a diagnostic survey of job classification and grading, and the launch of a labor market survey on wage differentials between private and public sector jobs; and
- public expenditure management and services delivery, including the closure and consolidation of federal and regional accounts up to 1998/99 and the initiation of financial audits for 1998/99, and the automation of 50 percent of all personnel records at the federal level, with an action plan for the reconciliation with payroll data.

In line with the **Country Assistance Strategy (CAS)** discussed by the Executive Board of the World Bank in April 2003, the World Bank will continue and strengthen its supports to Ethiopia's structural reform efforts. A major assistance vehicle envisaged in the CAS is the **Poverty Reduction Support Credit (PRSC)**. The PRSC, currently under preparation, will support reforms promoting growth in urban and rural areas, including improved investment climate, improved financial sector performance, better infrastructure provision, more efficient institutions supporting private sector development, more efficient domestic input and output markets. Furthermore, the **Public Sector Capacity Building Project (PSCAP)**, also under preparation, will support public sector capacity-building efforts to strengthen decentralized service delivery.

Statistical issues

35. **Progress is being made in improving the statistical base with technical assistance from the Fund and other donors.** The reconciliation of monetary and fiscal accounts, to be implemented with the help of further technical assistance from the Fund, is set as a benchmark for December 2003. The compilation of real sector data and the balance of payments is to be improved with the support of technical assistance from AFRITAC. Ethiopia is also implementing the GDDS. The World Bank is helping to improve data on poverty and social indicators, and to monitor the output and outcomes of the poverty reduction programs.

PRGF arrangement monitoring

36. The staff reached understandings on quantitative performance criteria for end-September 2003, benchmarks for end-December 2003, and indicative targets for March 2004 (Appendix I, Table 3).²³ It reached understandings on prior actions, particularly the key objectives of the CBE's restructuring (paragraph 24 of the MEFP), for consideration of the fourth review and third annual program by the Executive Boards, as well as on structural performance criteria and benchmarks through January 2004 (Appendix I, Table 4). The fifth program review is scheduled to be completed by December 2003, and would assess progress in policy implementation, and reach understandings on performance criteria and benchmarks for the second half of the 2003/04 program year.

IV. STAFF APPRAISAL

37. **Although Ethiopia has been severely affected by the drought—the worst since 1984/85, policy performance in most areas of the PRGF-supported program remains broadly satisfactory.** While the main priority for the authorities and donors should remain meeting the immediate needs of those affected by the drought, the government should also focus on solutions that will address the recurring problems of the drought in a more sustainable way. The resettlement and water harvesting schemes currently being pursued are a good start, but the authorities' efforts, with donor support, should also focus on taking lasting structural measures to achieve food security in the future, including irrigation schemes, land reform, and the development of basic infrastructure in rural areas.

38. **The delays in completing discussions on the fourth PRGF review and the third annual program were due to delays in finalizing the audit of the CBE, which was completed only in early May.** The structural benchmark on reducing NPLs of the CBE was also not achieved. The authorities are to be commended for their sustained commitment to implement the other elements of the program. Although capacity and skill shortages

²³ The definition of the quantitative performance criteria will be the same as in the second annual program and are set out in the technical memorandum of understanding (TMU).

combined with the demands of the fiscal decentralization process, have led to delays in meeting two benchmarks on public expenditure management, the authorities remain committed to implementing them.

39. Provided the PRGF-supported program continues to be implemented effectively, its revised objectives are likely to be achieved. However, **for a sustainable and higher real GDP growth to be achieved, the pace of structural reforms needs to be accelerated,** financial sector reform deepened, and the climate for private domestic and foreign investment greatly enhanced in order to contribute to job and income creation. In particular, the authorities will need to focus on four critical areas.

40. **First, fiscal policy will need to continue to focus on prudent public expenditure management and enhanced revenue mobilization.** To avoid jeopardizing macroeconomic stability and debt sustainability, the medium-term macroeconomic framework will need to be carefully assessed once additional external financing has been identified. In addition to effective implementation of the VAT introduced in January 2003, and improved tax administration, close monitoring of tax evasion and the collection of tax arrears will be critical to achieving the revenue target. If revenue falls short of the projected level, additional measures may need to be considered. A prudent expenditure policy will need to be pursued, focusing on poverty-reduction activities identified in the PRSP. The authorities should also proceed decisively with their ongoing plans for improving public expenditure management, especially poverty-targeted spending, at the federal, regional, and district levels. A comprehensive and prudent domestic and external debt management strategy will also need to be pursued.

41. **Second, in the monetary and exchange areas, monetary policy will need to remain geared toward achieving the inflation and international reserve targets under the program.** To help achieve these targets while providing room for an adequate increase in credit to the nongovernment sector, the government should limit recourse to borrowing from the banking sector to the programmed level to finance food security and drought-related spending in 2003/04. The government should also continue sterilizing the excess reserves held by commercial banks and allowing interest rates to be market-determined. The exchange rate should continue to be market determined and efforts should be made to strengthen the effectiveness of the interbank foreign exchange market. The staff encourages the authorities to eliminate the few remaining exchange restrictions, and to speeding the implementation of the recommendations made in the Safeguard Assessment of the NBE.

42. **Third, the government should pursue vigorously reforms aimed at strengthening the financial sector and improving competition in the sector.** The measures envisaged during 2003/04 should be implemented steadfastly including (a) full provisioning by banks for NPLs and other doubtful assets in line with international best practices; (b) finalizing the financial restructuring of the Development Bank of Ethiopia; (c) taking steps to strengthen the National Bank of Ethiopia (NBE), following the completion of the ongoing comprehensive study of the NBE, including as necessary, revising the existing Banking Act to increase NBE's autonomy by end-2003; and (d) restructuring of the CBE. With respect to

the latter, staff welcome the completion of the independent audit, carried out according to International Accounting Standards by a reputable firm. The audit recommended that the NPLs issue be addressed, actions be taken to restore the profitability of CBE, and that credit risk and portfolio management be significantly strengthened. The staff urge the authorities to promptly finalize and start implementing a restructuring plan that addresses all these issues. Staff also continue to urge the authorities to open up more of the financial sector to the private sector, including allowing foreign bank entry.

43. **Fourth, it is essential to adhere to the agenda for other structural reforms.** The authorities, with the assistance of the World Bank and bilateral donors, are implementing reforms focusing on agriculture, food security, capacity building, export promotion, the privatization program, strengthening the legal and regulatory framework, and supporting private sector development. The authorities should also ensure that all HIPC Initiative triggers are met, and that the first annual PRSP progress report is prepared by end-2003.

44. **With the continued implementation of sound policies and consolidation of the peace process, the medium-term outlook for the Ethiopian economy remains encouraging.** In view of the authorities' commitment to the satisfactory implementation of the program and to ensure its success, the staff recommends that the present review under the PRGF arrangement be completed, that the arrangement be extended to end-July 2004, and that additional interim assistance under the enhanced HIPC Initiative for the period November 8, 2003 –May 31, 2004 be provided.

Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2005/06 1/

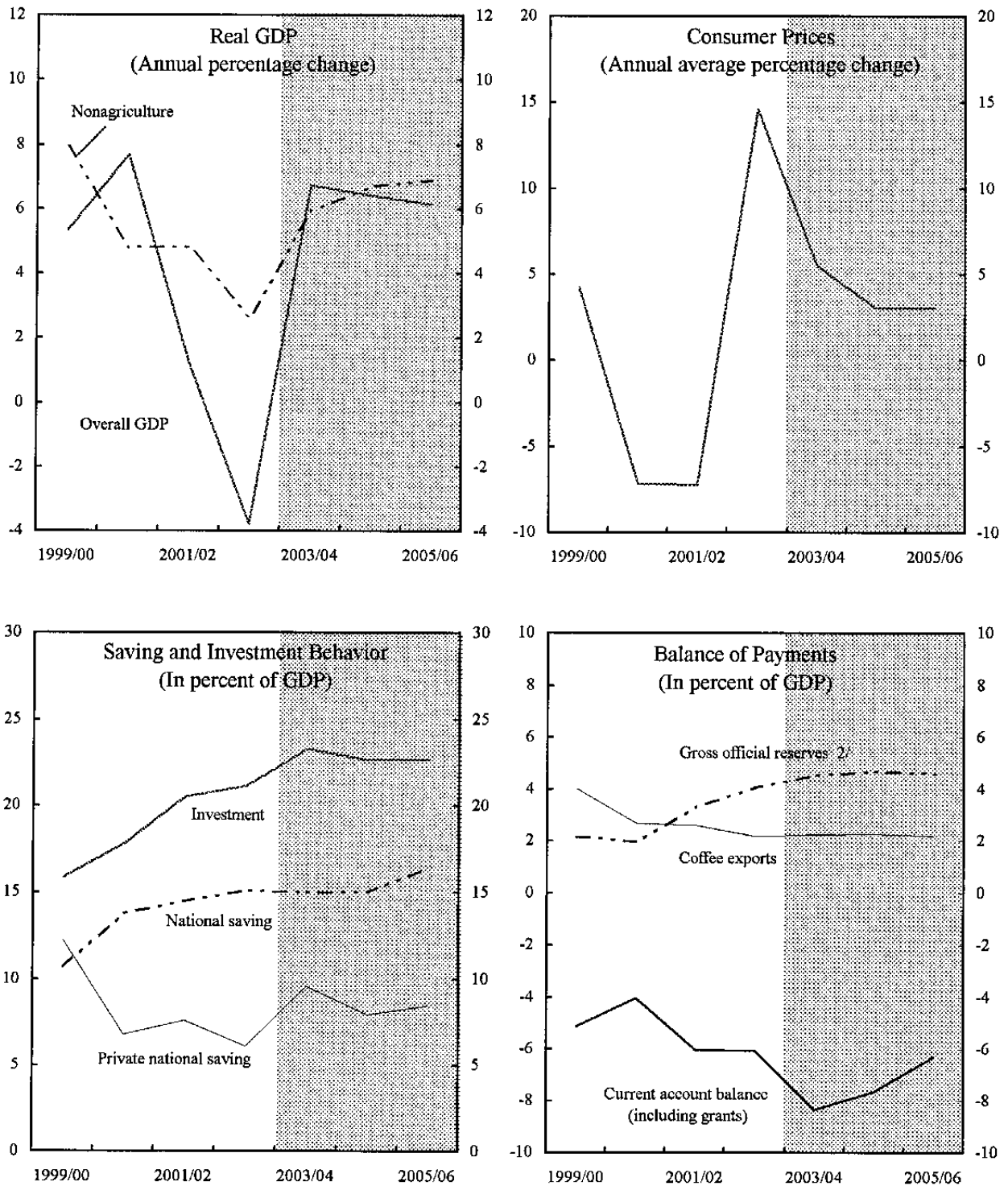
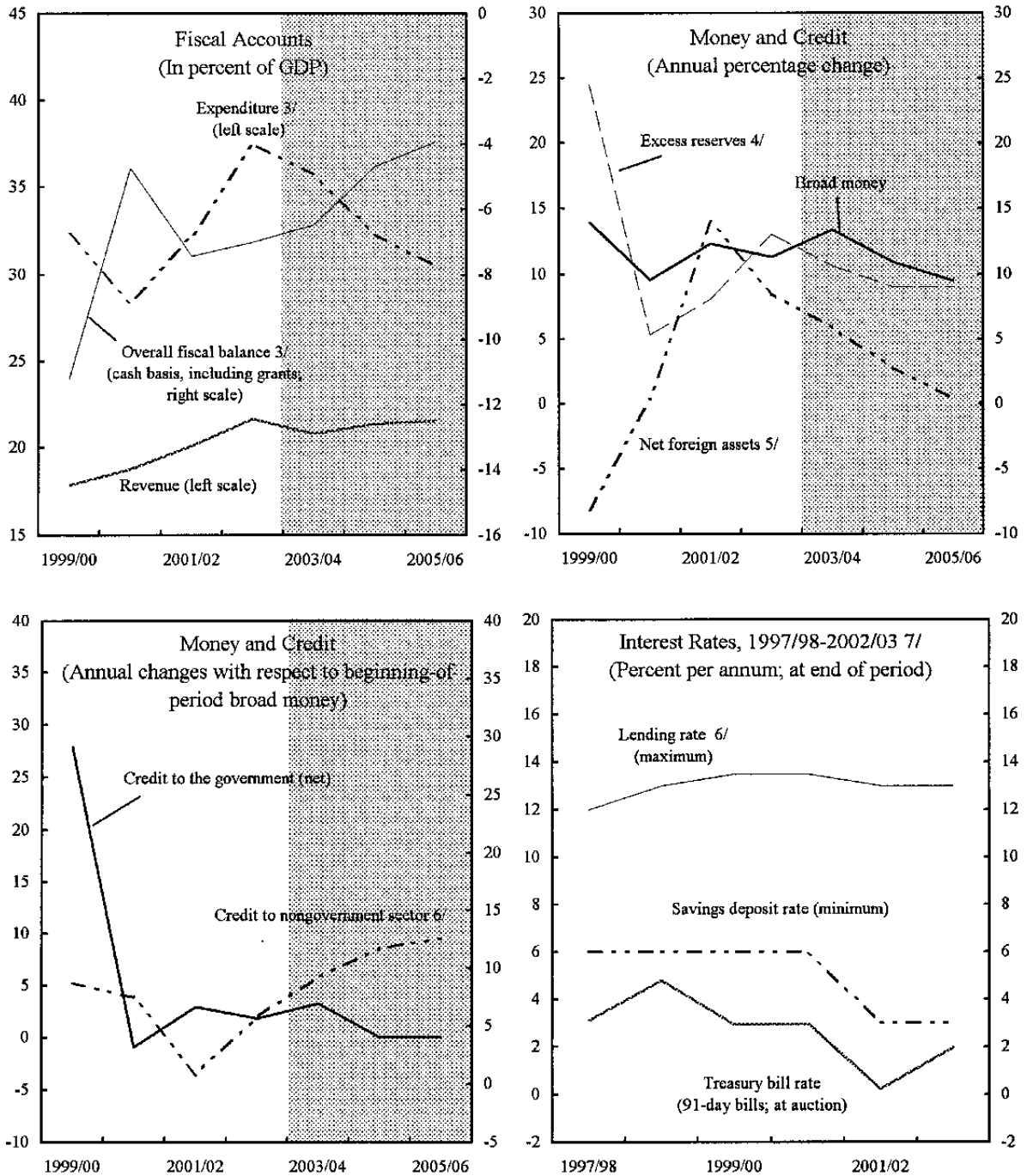


Figure 1. Ethiopia: Selected Economic Indicators, 1999/2000-2005/06 1/ (concluded)



Sources: Ethiopian authorities; and staff estimates and projections.

1/ All data pertain to the period July 8-July 7. Shaded area indicates program period.

2/ In months of imports of goods and nonfactor services of the following year.

3/ Excluding special programs.

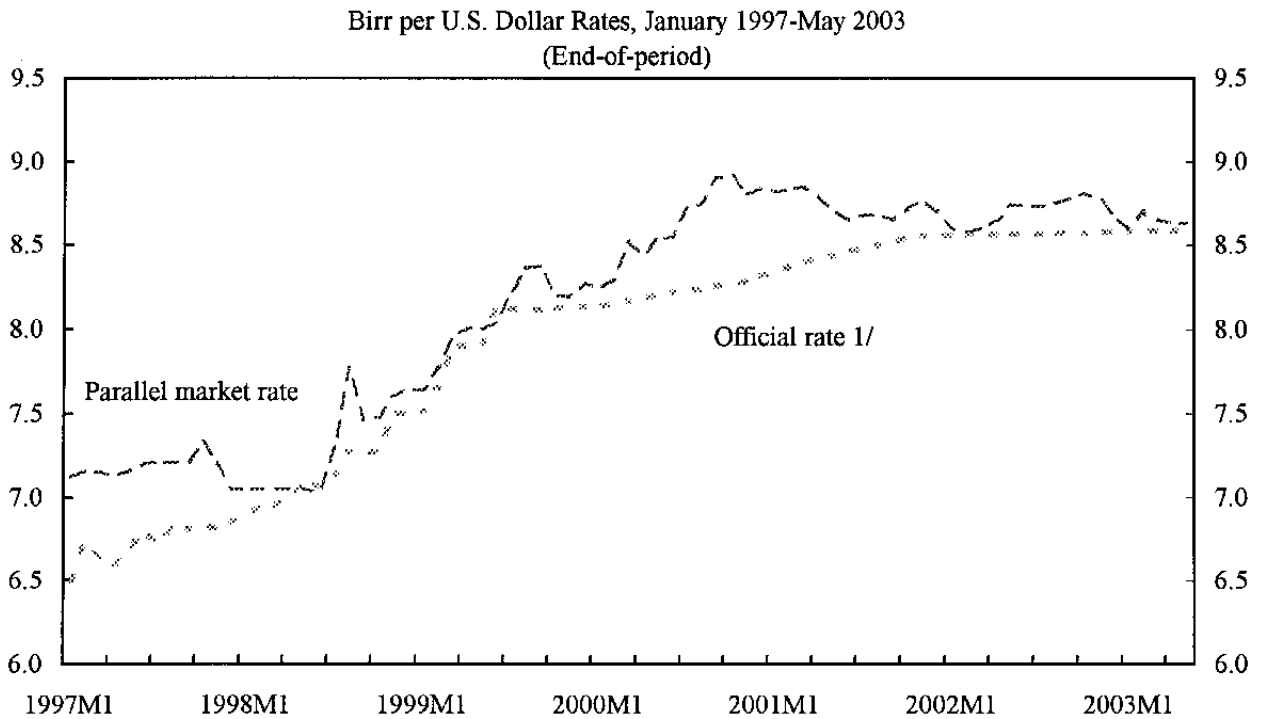
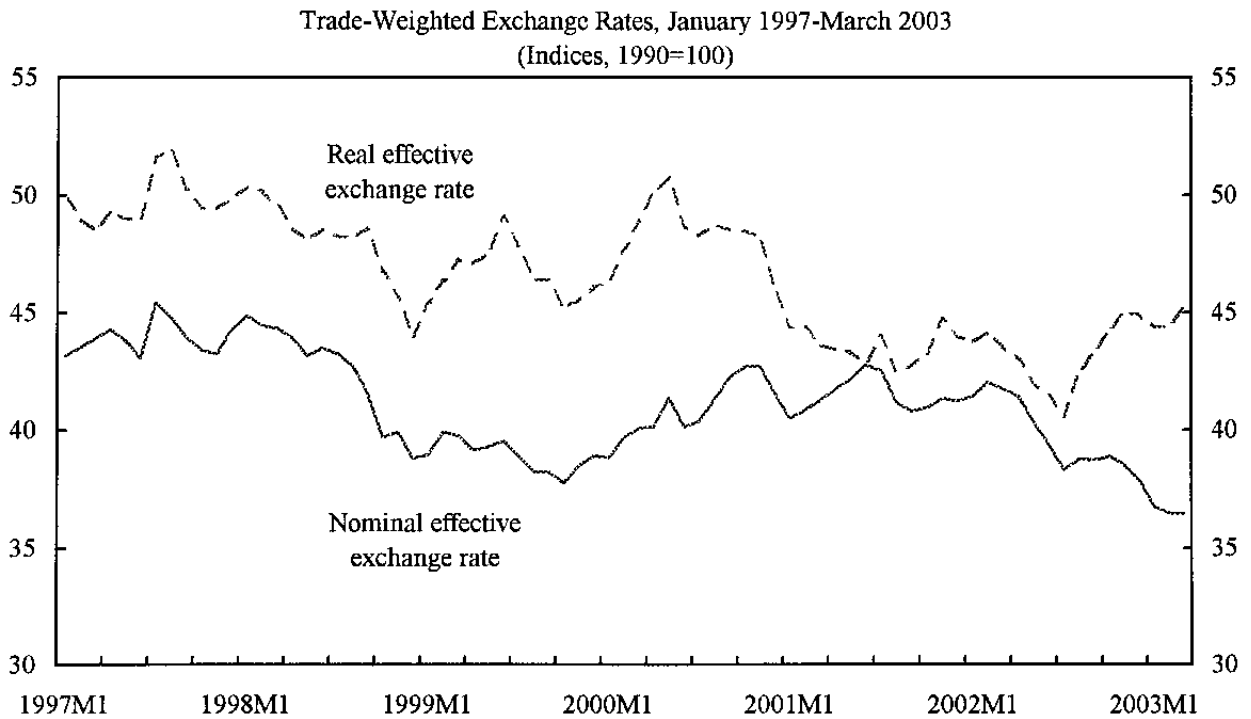
4/ In percent of deposits.

5/ Change in percent of beginning-of-period broad money.

6/ Includes credit to public enterprises and the private sector.

7/ As of March 2003

Figure 2. Ethiopia: Exchange Rate Developments



Sources: IMF, Information Notice System; National Bank of Ethiopia; and staff estimates.

1/ Until September 2001, the marginal rate at the foreign exchange auction conducted by the National Bank of Ethiopia; thereafter, the transaction-weighted foreign exchange interbank market rate.

Table 1. Ethiopia: Schedule of Disbursements and Repayments Under the PRGF Arrangement, 2003-04

	Position on May 31, 2003	2003		2004	
		Jan.-June	July-Dec.	Jan.-June	July-Dec.
(In millions of SDRs)					
Net use of Fund resources					
Repayments	...	5.0	5.0	4.4	4.4
Projected disbursements	...	0.0	20.8	10.4	0.0
Fund resources outstanding (end of period)	100.4	99.7	115.5	121.6	117.2
(In percent of quota) 1/					
Net use of Fund resources					
Repayments	...	3.7	3.7	3.3	3.3
Projected disbursements	...	0.0	7.8	7.8	0.0
Fund resources outstanding (end of period)	75.1	74.6	86.4	90.9	87.7

Source: Fund staff calculations and projections.

1/ Quota of SDR 133.7 million.

Table 2. Ethiopia: Proposed Schedule of Remaining Disbursements and Conditions for Disbursements Under the PRGF Arrangement, 2003-04

	Amount		Availability	Conditions Include:
	SDR	Percent of quota		
	10,429,000	7.8	August 29, 2003	Observance of end-September 2002 performance criteria, completion of fourth review, and approval of third annual program.
	10,429,000	7.8	December 15, 2003	Completion of fifth review and observance of end-September 2003 performance criteria.
	10,429,000	7.8	June 15, 2004	Completion of sixth review and observance of end-March 2004 performance criteria.
Total	31,287,000	23.4		

Table 3. Ethiopia: Selected Economic and Financial Indicators, 2000/01-2005/06 1/

	2000/01	2001/02		2002/03		2003/04		2004/05		2005/06
		EBS/02/158	Est.	EBS/02/158	Est.	EBS/02/158	Rev. Prog.	EBS/02/158	Rev. Prog.	Rev. Proj.
(Annual percentage change)										
National income and prices										
GDP at constant prices (at factor cost)	7.7	5.0	1.2	6.0	-3.8	6.0	6.7	6.0	6.4	6.1
GDP deflator	-6.4	-7.4	-7.0	4.9	13.3	3.7	5.2	4.0	3.4	3.2
Consumer prices (period average)	-7.2	-7.2	-7.2	4.5	14.6	3.0	5.5	3.0	3.0	3.0
External sector										
Exports, f.o.b.	-9.3	-9.3	-2.2	9.4	8.6	12.7	9.8	16.0	10.3	8.9
Imports, c.i.f.	-3.4	4.7	9.0	3.7	16.5	4.9	6.4	4.9	1.4	1.5
Export volume	-1.7	-0.4	10.3	7.2	7.8	7.0	7.7	8.0	7.5	7.3
Import volume	-1.9	7.3	11.8	4.0	12.6	4.0	2.1	4.2	1.7	1.4
Terms of trade (deterioration -)	-6.2	-6.6	-8.9	2.3	-2.7	4.4	-2.2	6.7	3.0	1.3
Nominal effective exchange rate (end of period) 2/	6.5	...	-7.8	...	-7.8	...	...	...	...	...
Real effective exchange rate (end of period) 2/	-12.0	...	-3.3	...	10.8	...	...	...	...	...
(In percent of beginning-period stock of broad money, unless otherwise indicated)										
Money and credit										
Net foreign assets	0.3	11.4	14.0	5.4	8.5	2.6	5.9	...	2.8	0.4
Net domestic assets	9.2	-0.5	-1.7	7.1	2.8	7.5	7.5	...	8.1	9.1
Net claims on the government	-0.9	0.0	2.9	1.8	1.8	0.0	3.3	...	0.0	0.0
Credit to the nongovernment sector	3.8	-0.8	-3.5	6.0	2.0	7.8	5.8	...	8.6	9.5
Broad money	9.5	10.9	12.3	12.4	11.3	10.0	13.4	...	10.9	9.5
Velocity (GDP/broad money)	2.2	1.9	1.9	1.9	1.8	1.9	1.8	...	1.8	1.8
Interest rates (in percent at end of period) 2/										
Savings deposits (minimum rate)	6.0	3.0	3.0	...	3.0	...	...	...	...	...
Lending rates (maximum rate)	13.5	14.0	13.0	...	13.0	...	...	...	...	...
Treasury bill (91-day maturity)	3.0	0.3	0.2	...	2.0	...	...	...	...	...
(In percent of GDP, unless otherwise indicated)										
Financial balances										
Gross domestic saving	2.6	1.5	2.2	3.5	0.5	5.6	3.5	7.3	4.8	6.8
Government saving	2.0	0.7	0.8	0.9	0.9	3.0	0.3	3.9	2.8	4.3
Private saving	0.7	0.8	1.4	2.5	-0.4	2.5	3.2	3.4	1.9	2.5
Gross domestic investment	17.8	20.2	20.5	20.4	21.2	21.2	23.3	21.4	22.6	22.7
Government investment	8.5	12.6	11.5	12.5	11.5	11.5	13.5	10.8	11.7	11.1
Private investment	9.3	7.5	9.0	8.0	9.6	9.7	9.8	10.6	10.9	11.6
Resource gap	-15.2	-18.6	-18.3	-17.0	-20.6	-15.7	-19.8	-14.1	-17.9	-15.9
External current account balance, including official transfers	-4.0	-6.6	-6.0	-6.9	-6.1	-5.4	-8.3	-4.0	-7.6	-6.3
Saving-investment (government)	-1.5	-6.2	-4.6	-7.9	-2.6	-4.8	-8.1	-3.3	-4.6	-3.1
Saving-investment (private)	-2.5	-0.4	-1.4	1.0	-3.5	-0.6	-0.3	-0.6	-3.0	-3.2
External current account balance, excluding official transfers	-10.1	-13.5	-13.2	-11.6	-15.2	-10.0	-14.4	-8.5	-12.8	-10.7
Government finances										
Revenue	18.8	21.7	20.1	21.8	21.7	22.5	20.8	22.3	21.4	21.6
Tax revenue	13.7	16.2	15.3	16.6	16.0	17.4	16.5	18.1	17.3	17.6
Nontax revenue	5.0	5.5	4.8	5.2	5.7	5.2	4.3	4.2	4.1	3.9
External grants	4.8	5.3	4.7	4.8	8.8	4.7	8.5	4.6	6.2	5.0
Expenditure and net lending 3/	28.4	34.9	32.2	34.6	37.5	32.2	35.7	31.5	32.3	30.5
Fiscal balance, excluding grants (cash basis) 3/	-9.6	-13.2	-12.1	-12.8	-15.8	-9.7	-14.9	-9.2	-10.9	-8.9
Fiscal balance, including grants (cash basis) 3/	-4.8	-7.9	-7.4	-8.0	-7.0	-5.0	-6.5	-4.7	-4.7	-3.9
Special programs 4/	0.7	2.0	1.9	1.7	1.5	1.4	1.0	0.0	0.6	0.0
Fiscal balance, including grants and special programs	-5.5	-9.9	-9.3	-9.7	-8.5	-6.4	-7.5	-4.7	-5.3	-3.9
Total financing	5.5	9.9	9.3	9.7	8.5	6.4	7.5	4.7	5.3	3.9
External financing	3.8	9.1	9.5	8.2	7.6	5.5	5.5	4.2	4.7	3.4
Domestic financing (including residual)	0.9	0.4	-0.3	0.9	0.9	0.5	1.8	0.4	0.4	0.4
Privatization receipts	0.7	0.4	0.1	0.6	0.0	0.5	0.2	0.0	0.1	0.1
Domestic debt 5/	37.4	40.7	39.8	41.6	37.5	41.9	35.2	42.3	32.4	29.8
External debt (including to Fund) 6/	86.3	102.3	101.1	98.5	98.7	93.3	91.9	86.8	86.8	81.0
NPV of external debt-to-exports ratio (including to Fund) 7/	170.9	182.0	169.2	214.2	191.6	220.9	203.4	220.4	210.5	210.0
NPV of external debt-to-revenue ratio (including to Fund) 8/	134.0	125.2	133.5	144.0	145.2	146.4	155.9	149.3	155.7	151.0
External debt-service ratio 9/	23.2	22.4	17.0	20.7	15.0	18.7	15.8	16.9	16.2	15.3
External debt-service ratio 10/	...	11.4	10.9	8.6	6.9	7.3	7.4	8.1	8.1	7.6
Overall balance of payments (in millions of U.S. dollars)	-64	232	248	5	53	-92	-131	-86	-160	-149
Gross official reserves (in millions of U.S. dollars)	337	679	664	773	874	841	988	899	1,039	1,032
(in months of imports of goods and nonfactor services of following year)	2.0	3.9	3.3	4.3	4.1	4.4	4.5	4.5	4.7	4.6
GDP at current market prices (in millions of birr)	54,211	51,158	51,761	57,092	56,192	62,922	63,139	69,590	69,681	76,582
Exchange rate (birr per U.S. dollar, period average rate)	8.34	8.54	8.54	...	...	...	...	...	...	...

Sources: Ethiopian authorities, and staff estimates and projections.

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

2/ As of end March 2003.

3/ Excluding special programs.

4/ Demobilization and reconstruction.

5/ Whole series was revised.

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

7/ After enhanced HIPC relief. Exports of goods and services used.

8/ After enhanced HIPC relief. Revenues exclude grants.

9/ Before debt relief; on an accrual basis; in percent of exports of goods and nonfactor services.

10/ After enhanced HIPC relief.

Table 4. Ethiopia: General Government Operations, 2000/01-2005/06 1/
(In millions of birr)

	2000/01	2001/02	2002/03		2003/04		2004/05	2005/06
			EBS/02/158	Estimate	EBS/02/158	Rev. Prog. 4/	Rev. Proj. 4/	Rev. Proj. 4/
Total revenue and grants	12,805	12,833	15,189	17,130	17,115	18,476	19,240	20,335
Revenue	10,177	10,409	12,441	12,174	14,186	13,140	14,904	16,516
Tax revenue (incl. measures)	7,440	7,926	9,464	8,994	10,940	10,432	12,038	13,501
Direct taxes	2,734	3,120	3,740	3,255	4,397	3,923	4,704	5,200
Indirect taxes	4,706	4,806	5,724	5,739	6,543	6,508	7,334	8,301
Domestic indirect taxes	1,381	1,498	1,862	1,862	2,240	2,280	2,811	3,350
Import duties and taxes	3,231	3,280	3,828	3,874	4,278	4,228	4,498	4,921
Export taxes	93	28	34	3	25	0	25	30
Nontax revenue	2,737	2,483	2,977	3,180	3,246	2,708	2,867	3,015
Grants	2,628	2,425	2,748	4,956	2,929	5,336	4,336	3,819
Total expenditure and net lending (cash basis) 2/	15,382	16,680	19,734	21,063	20,272	22,563	22,521	23,357
Recurrent expenditure 2/	10,379	10,550	12,310	14,285	12,714	13,310	13,707	13,939
Defense spending	3,307	2,610	3,000	3,000	3,000	3,000	3,000	3,000
Poverty-targeted expenditure	2,717	3,093	3,853	3,853	4,237	4,446	4,893	5,338
Education	1,513	1,777	2,172	2,172	2,390	2,513	2,700	3,100
Health	470	522	622	622	684	711	819	832
Agriculture	636	675	898	898	987	1,038	1,164	1,190
Roads	99	119	161	161	177	183	210	216
Interest payments (after traditional debt-relief mechanism)	1,080	1,005	1,280	1,280	1,311	1,406	1,526	1,531
Domestic interest and charges	575	572	686	686	692	773	768	762
External interest payments (after traditional debt-relief mechanism)	505	433	594	594	619	633	758	769
Emergency assistance (food and other emergency aid)	978	1,006	902	3,010	886	876	896	906
Others	2,297	2,837	3,275	3,142	3,279	3,583	3,393	3,164
Capital expenditure 2/	5,003	6,130	7,424	6,778	7,559	9,252	8,814	9,418
<i>Of which: poverty-targeted expenditure</i>	3,658	4,460	6,669	6,088	7,045	6,841	7,550	8,573
Balance, excl. special programs (cash basis)								
Including grants	-2,577	-3,847	-4,545	-3,933	-3,157	-4,087	-3,281	-3,022
Excluding grants	-5,205	-6,272	-7,293	-8,889	-6,085	-9,423	-7,617	-6,841
Special programs 3/	404	971	982	863	887	644	424	0
Overall balance 4/								
Including grants	-2,981	-4,818	-5,527	-4,796	-4,043	-4,731	-3,705	-3,022
Excluding grants	-5,609	-7,243	-8,275	-9,752	-6,972	-10,067	-8,041	-6,841
Financing	2,981	4,818	5,527	4,796	4,044	4,731	3,705	3,022
External (net)	2,070	4,905	4,677	4,284	3,444	3,469	3,305	2,622
Gross borrowing	2,686	5,172	4,555	4,162	3,574	3,455	3,517	2,890
HIPC Initiative relief	0	429	779	779	806	819	733	784
Amortization repayment (after traditional debt-relief mechanism)	-616	-696	-657	-657	-937	-805	-945	-1,052
Domestic (net)	57	309	500	500	300	1,162	300	300
Banking system	-213	723	500	500	0	1,000	0	0
Nonbank sources	270	-414	0	0	300	162	300	300
Privatization	400	68	350	13	300	100	100	100
Float/unidentified financing	454	-464	0	0	0	0	0	0
Memorandum items:								
Poverty-targeted expenditure	6,375	7,553	10,522	9,941	11,282	11,287	12,443	13,911
Wages and salaries	3,597	3,789	4,455	4,385	4,908	4,925	5,435	5,973
HIPC Initiative relief on interest	0	235	420	420	328	328	...	...
HIPC Initiative relief on amortization	0	190	359	359	479	479	...	...
Gross domestic product	54,211	51,761	57,092	56,192	62,922	63,139	69,681	76,582

Sources: Ethiopian authorities; and Fund staff estimates and projections.

1/ Fiscal year ending July 7.

2/ Excluding special programs (demobilization and reconstruction).

3/ Demobilization and reconstruction.

4/ Projections for overall balance will change after IDA's lending program is reassessed at the HIPC completion point.

Table 5. Ethiopia: General Government Operations, 2000/01-2005/06 1/
(In percentage of GDP)

	2000/01	2001/02	2002/03		2003/04		2004/05	2005/06
			EBS/02/158	Estimate.	EBS/02/158	Rev. Proj.	Rev. Proj.	Rev. Proj.
						4/	4/	4/
Total revenue and grants	23.6	24.8	26.6	30.5	27.2	29.3	27.6	26.6
Revenue	18.8	20.1	21.8	21.7	22.5	20.8	21.4	21.6
Tax revenue (incl. measures)	13.7	15.3	16.6	16.0	17.4	16.5	17.3	17.6
Direct taxes	5.0	6.0	6.6	5.8	7.0	6.2	6.8	6.8
Indirect taxes	8.7	9.3	10.0	10.2	10.4	10.3	10.5	10.8
Domestic indirect taxes	2.5	2.9	3.3	3.3	3.6	3.6	4.0	4.4
Import duties and taxes	6.0	6.3	6.7	6.9	6.8	6.7	6.5	6.4
Export taxes	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Nontax revenue	5.0	4.8	5.2	5.7	5.2	4.3	4.1	3.9
Grants	4.8	4.7	4.8	8.8	4.7	8.5	6.2	5.0
Total expenditure and net lending (cash basis) 2/	28.4	32.2	34.6	37.5	32.2	35.7	32.3	30.5
Recurrent expenditure 2/	19.1	20.4	21.6	25.4	20.2	21.1	19.7	18.2
Defense spending	6.1	5.0	5.3	5.3	4.8	4.8	4.3	3.9
Poverty-targeted expenditure	5.0	6.0	6.7	6.9	6.7	7.0	7.0	7.0
Education	2.8	3.4	3.8	3.9	3.8	4.0	3.9	4.0
Health	0.9	1.0	1.1	1.1	1.1	1.1	1.2	1.1
Agriculture	1.2	1.3	1.6	1.6	1.6	1.6	1.7	1.6
Roads	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Of which: HIPC poverty-targeted expenditure	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0
Interest payments (after traditional debt-relief mechanism)	2.0	1.9	2.2	2.3	2.1	2.2	2.2	2.0
Domestic interest and charges	1.1	1.1	1.2	1.2	1.1	1.2	1.1	1.0
External interest payments (after traditional debt-relief mechanism)	0.9	0.8	1.0	1.1	1.0	1.0	1.1	1.0
Emergency assistance (food and other emergency aid)	1.8	1.9	1.6	5.4	1.4	1.4	1.3	1.2
Others	4.2	5.5	5.7	5.6	5.2	5.7	4.9	4.1
Capital expenditure 2/	9.2	11.8	13.0	12.1	12.0	14.7	12.6	12.3
Of which: poverty-targeted expenditure	6.7	8.6	11.7	10.8	11.2	10.8	10.8	11.2
Balance, excl. special programs (cash basis)								
Including grants	-4.8	-7.4	-8.0	-7.0	-5.0	-6.5	-4.7	-3.9
Excluding grants	-9.6	-12.1	-12.8	-15.8	-9.7	-14.9	-10.9	-8.9
Special programs 3/	0.7	1.9	1.7	1.5	1.4	1.0	0.6	0.0
Overall balance 4/								
Including grants	-5.5	-9.3	-9.7	-8.5	-6.4	-7.5	-5.3	-3.9
Excluding grants	-10.3	-14.0	-14.5	-17.4	-11.1	-15.9	-11.5	-8.9
Financing	5.5	9.3	9.7	8.5	6.4	7.5	5.3	3.9
External (net)	3.8	9.5	8.2	7.6	5.5	5.5	4.7	3.4
Gross borrowing	5.0	10.0	8.0	7.4	5.7	5.5	5.0	3.8
HIPC Initiative relief	0.0	0.8	1.4	1.4	1.3	1.3	1.1	1.0
Amortization repayment (after traditional debt-relief mechanism)	-1.1	-1.3	-1.2	-1.2	-1.5	-1.3	-1.4	-1.4
Domestic (net)	0.1	0.6	0.9	0.9	0.5	1.8	0.4	0.4
Banking system	-0.4	1.4	0.9	0.9	0.0	1.6	0.0	0.0
Nonbank sources	0.5	-0.8	0.0	0.0	0.5	0.3	0.4	0.4
Privatization	0.7	0.1	0.6	0.0	0.5	0.2	0.1	0.1
Float/unidentified financing	0.8	-0.9	0.0	0.0	0.0	0.0	0.0	-0.0
Memorandum items:								
Poverty-targeted expenditure	11.8	14.6	18.4	17.7	17.9	17.9	17.9	18.2
Wages and salaries	6.6	7.3	7.8	7.8	7.8	7.8	7.8	7.8
HIPC Initiative relief on interest	0.0	0.5	0.7	0.7	0.5	0.5	...	...
HIPC Initiative relief on amortization	0.0	0.4	0.6	0.6	0.8	0.8	...	...

Sources: Ethiopian authorities; and Fund staff estimates and projections.

1/ Fiscal year ending July 7.

2/ Excluding special programs (demobilization and reconstruction).

3/ Demobilization and reconstruction.

4/ Projections for overall balance will change after IDA's lending program is reassessed at the HIPC completion point.

Table 6. Ethiopia: Monetary Survey, 2000/01-2005/06 1/

	2000/01	2001/02	2002/03		2003/04		2004/05 Rev. Proj.	2005/06 Rev. Proj.
			EBS/02/158	Est.	EBS/02/158	Rev. Prog.		
(In millions of birr)								
Net foreign assets	4,861	8,295	9,124	10,645	9,918	12,452	13,421	13,562
National Bank of Ethiopia (NBE)	1,661	4,225	4,736	6,047	5,259	7,134	7,633	7,715
Assets	2,857	5,692	6,818	7,514	7,498	8,804	9,369	9,402
Liabilities	1,196	1,467	2,083	1,468	2,239	1,670	1,736	1,687
Commercial banks	3,200	4,070	4,389	4,598	4,659	5,318	5,787	5,847
Assets	5,125	5,729	6,393	6,262	6,684	7,043	7,533	7,610
Liabilities	1,925	1,659	2,004	1,664	2,026	1,725	1,745	1,763
Net domestic assets	19,740	19,327	21,539	20,094	23,827	22,397	25,232	28,756
Domestic credit	27,764	27,617	29,715	28,664	32,105	31,447	34,436	38,098
Claims on government (net) 2/	15,544	16,268	16,044	16,768	16,044	17,768	17,768	17,768
NBE	9,850	9,006	9,702	9,506	9,702	10,506	10,506	10,506
Commercial banks	5,695	7,262	6,343	7,262	6,343	7,262	7,262	7,262
Claims on non-government (net)	12,220	11,349	13,671	11,896	16,060	13,679	16,668	20,330
NBE	394	394	394	394	394	394	394	394
Commercial banks	11,826	10,955	13,277	11,502	15,666	13,285	16,274	19,936
Other items (net)	-8,024	-8,290	-8,176	-8,570	-8,278	-9,050	-9,204	-9,342
Broad money	24,598	27,622	30,664	30,739	33,745	34,849	38,653	42,318
Money	13,778	15,457	17,510	16,671	19,091	19,401	21,092	22,071
Currency outside banks	5,930	6,536	7,788	7,292	8,908	9,315	9,626	8,852
Demand deposits	7,848	8,921	9,722	9,379	10,183	10,086	11,466	13,219
Quasi money	10,820	12,166	13,153	14,068	14,654	15,448	17,561	20,247
Savings deposits	9,824	11,071	11,895	12,896	13,288	13,916	15,820	18,239
Time deposits	996	1,094	1,258	1,172	1,366	1,532	1,742	2,008
(Annual change in percent of beginning-period broad money, unless otherwise indicated)								
Net foreign assets	0.3	14.0	5.4	8.5	2.6	5.9	2.8	0.4
Net domestic assets	9.2	-1.7	7.1	2.8	7.5	7.5	8.1	9.1
Domestic credit	2.9	-0.6	7.9	3.8	7.8	9.1	8.6	9.5
Claims on government (net)	-0.9	2.9	1.8	1.8	0.0	3.3	0.0	0.0
Claims on non-government (net)	3.8	-3.5	6.0	2.0	7.8	5.8	8.6	9.5
Broad money	9.5	12.3	12.4	11.3	10.0	13.4	10.9	9.5
Money	2.3	6.8	8.4	4.4	5.2	8.9	4.9	2.5
Quasi money	7.3	5.5	4.1	6.9	4.9	4.5	6.1	6.9
Memorandum items:								
Quasi money/broad money (in percent)	44.0	44.0	42.9	45.8	43.4	44.3	45.4	47.8
Velocity (GDP/broad money)	2.20	1.87	1.86	1.83	1.86	1.81	1.80	1.81
Gross official foreign reserves (in millions of U.S. dollars)	337	664	773	874	841	988	1,039	1,032
Net foreign assets of the banking system (in millions of U.S. dollar)	574	968	1,035	1,239	1,113	1,398	1,489	1,489
Excess reserves (in percent of deposits)	5.3	8.1	7.6	13.0	5.1	10.6	9.0	9.0

Sources: National Bank of Ethiopia, and Fund staff estimates and projections.

1/ Year ending July 7.

2/ Claims on general government (federal and regional governments and other public agencies) by the banking system less deposits of the general government with the banking system.

Table 7. Ethiopia: Balance of Payments, 2000/01-2005/06
(In millions of U.S. dollars, unless otherwise indicated)

	2000/01	2001/02	2002/03		2003/04		2004/05 Rev. Proj.	2005/06 Rev. Proj.
			EBS/02/158	Est.	EBS/02/158	Rev. Proj.		
Trade balance	-1,115	-1,264	-1,251	-1,508	-1,278	-1,589	-1,565	-1,547
Exports of goods	441	431	437	468	493	514	567	617
Coffee	175	158	179	142	204	161	175	185
Other	266	274	258	326	288	353	392	433
Imports of goods	1,556	1,696	1,689	1,976	1,771	2,103	2,132	2,164
Fuel	292	268	259	288	263	298	289	290
Cereals	78	155	80	295	45	150	110	80
Aircraft	14	11	0	12	0	117	117	117
Imports excl. fuel,cereals,aircraft	1,171	1,262	1,350	1,381	1,462	1,538	1,617	1,676
Nonfactor services (net)	129	153	138	159	167	162	175	200
Exports of nonfactor services	516	530	525	607	565	635	662	693
Imports of nonfactor services	387	377	387	448	398	473	487	493
Income (net)	-51	-51	-35	-55	-31	-40	-36	-30
<i>Of which</i> : gross official interest payments ^{2/}	-70	-63	-72	-72	-71	-71	-71	-70
Private transfers (net)	379	364	388	407	430	429	432	469
Current account balance, excl. official transfers (in percent of GDP)	-658 -10.1	-799 -13.2	-761 -11.6	-997 -15.2	-712 -10.0	-1,038 -14.4	-994 -12.8	-907 -10.7
excluding EAL imports						-12.8	-11.3	-9.3
Official transfers (net)	395	435	308	600	329	437	400	374
Current account balance, incl. official transfers (in percent of GDP)	-262 -4.0	-365 -6.0	-454 -6.9	-397 -6.1	-382 -5.4	-601 -8.3	-594 -7.6	-532 -6.3
excluding EAL imports						-6.7	-6.1	-4.9
Capital account balance (incl. errors and omissions)	198	613	458	450	291	470	434	383
Foreign direct investment (net)	52	0	40	20	60	20	50	70
Other investment (net)	207	393	418	430	231	450	384	313
Official long-term loans	194	374	435	447	247	466	396	326
Disbursements	320	459	525	537	348	567	503	436
EAL loan	0	0	0	0	0	117	117	117
Amortization ^{2/}	126	86	90	90	101	101	107	111
Other public sector long-term loans (net) ^{3/}	-14	19	-17	-17	-16	-16	-12	-12
Other (net)	26	0	0	0	0	0	0	0
Errors and omissions	-61	220	0	67	0	0	0	0
Overall balance	-64	248	5	53	-92	-131	-160	-149
Financing	64	-248	-5	-53	92	131	160	149
Central bank (net; increase -)	33	-235	-81	-210	-53	-97	-46	0
Reserves (increase -)	5	-321	-94	-210	-68	-114	-51	7
Liabilities (increase +)	27	86	13	0	15	17	5	-7
Fund credit (net)	10	43	13	0	15	17	5	-7
Commercial banks (net; increase -)	-26	-103	-60	-60	-25	-62	-45	0
Changes in arrears	-810	0	0	0	0	0	0	0
Debt relief (Paris Club II and III, Naples terms) ^{4/}	867	89	136	150	18	18	0	0
Financing gap	0	0	0	0	151	272	251	150
Exceptional financing ^{5/}	0	0	0	0	55	176	152	50
Traditional debt relief	0	0	0	0	6	6	21	20
HIPC relief	0	0	0	0	91	91	78	80
Residual gap	0	0	0	0	0	0	0	0
Memorandum items:								
Exports of goods (percent change)	-9.3	-2.2	9.4	8.6	12.7	9.8	10.3	8.9
Export price index (percent change)	-7.7	-11.3	2.0	0.7	5.3	1.9	2.6	1.4
Export volume index (percent change)	-1.7	10.3	7.2	7.8	7.0	7.7	7.5	7.3
Total imports of goods (percent change)	-3.4	9.0	3.7	16.5	4.9	6.4	1.4	1.5
Import price index (percent change)	-0.8	-2.7	-0.3	3.5	0.9	4.2	-0.3	0.1
Import volume index (percent change)	-1.9	11.8	4.0	12.6	4.0	2.1	1.7	1.4
Gross official reserves (in months of imports of goods and nonfactor services of following y excluding EAL aircraft imports)	337 2.0	664 3.3	773 4.3	874 4.1	841 4.4	988 4.5	1,039 4.7	1,032 4.6
Terms of trade index % change(1996/97 = 100)	-6.2	-8.9	2.3	-2.7	4.4	-2.2	3.0	1.3

Sources: Ethiopian authorities, and Fund staff estimates and projections.

^{2/} Includes debt service to Russia on ruble-denominated debt before up-front discount through 1999/2000; thereafter, after up-front discount.

^{3/} Ethiopian Airlines and other public enterprises.

^{4/} Includes 1997 and 2001 Paris Club rescheduling agreements (including Russia) under Naples terms, and 2002 Paris Club topping up to Cologne terms, and HIPC interim relief including estimates of relief beyond HIPC & relief on non-Paris Club debt under negotiation

^{5/} HIPC relief, balance of payments support from the World Bank (PRSC) and AfDB (SAL)

Table 8. Ethiopia: Projected Payments to the Fund, 2002/03-2012/13 1/
(In millions of SDRs, unless otherwise indicated)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Obligations from existing drawings	12.2	10.1	8.0	6.5	10.2	13.7	13.6	12.1	12.0	6.8	0.3
PRGF/ESAF/SAF repayments	11.4	9.4	7.3	5.9	9.6	13.2	13.2	11.7	11.7	6.5	0.0
Charges and interest 2/	0.7	0.7	0.7	0.6	0.6	0.5	0.4	0.4	0.3	0.3	0.3
Obligations from prospective drawings 3/	0.2	0.1	0.1	0.2	0.2	0.2	5.4	6.7	6.7	6.3	7.3
PRGF/ESAF/SAF repayments	0.0	0.0	0.0	0.0	0.0	0.0	5.2	6.6	6.6	6.3	7.3
Charges and interest 2/	0.2	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0
Total obligations 3/	12.3	10.2	8.1	6.7	10.4	13.9	19.0	18.8	18.7	13.1	7.6
PRGF/ESAF/SAF repayments	11.4	9.4	7.3	5.9	9.6	13.2	18.4	18.3	18.3	12.8	7.3
Charges and interest 2/	0.9	0.9	0.8	0.8	0.8	0.7	0.6	0.5	0.4	0.3	0.3
Outstanding Fund credit 3/ 4/	99.7	121.6	114.3	108.4	98.8	85.6	67.2	48.9	30.5	17.7	10.4
In percent of:											
Exports of goods and nonfactor services	9.3	10.6	9.3	8.3	6.9	5.5	4.0	2.7	1.6	0.8	0.5
External public debt	1.6	1.8	1.7	1.6	1.4	1.2	1.0	0.7	0.4	0.2	0.1
Gross official reserves	15.2	16.5	14.8	14.8	13.8	12.4	8.7	6.3	3.7	2.0	2.1
GDP	2.0	2.3	2.0	1.8	1.5	1.2	0.9	0.6	0.3	0.2	0.1
Quota	74.6	90.9	85.5	81.1	73.9	64.0	50.2	36.5	22.8	13.3	7.8
Total obligations	12.3	10.2	8.1	6.7	10.4	13.9	19.0	18.8	18.7	13.1	7.6
In percent of:											
Exports of goods and nonfactor services	1.1	0.9	0.7	0.5	0.7	0.9	1.1	1.0	1.0	0.6	0.3
External public debt	0.2	0.2	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.2	0.1
Gross official reserves	1.9	1.4	1.1	0.9	1.5	2.0	2.5	2.4	2.3	1.5	1.5
GDP	0.3	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Quota	9.2	7.6	6.1	5.0	7.8	10.4	14.2	14.1	14.0	9.8	5.7
Memorandum item:											
Projected disbursements	10.4	31.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Fund staff estimates and projections.

1/ Year ending July 7.

2/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the General Resources Account, and on current interest rates for the Enhanced Structural Adjustment Facility (ESAF)/Structural Adjustm

3/ This assumes that the full amount of the new PRGF arrangement (SDR 86.91 million) will be disbursed in seven installments, with each of the first two disbursements amounting to SDR 17 million, and each of the remaining five installments amounting to SD

4/ Under assumptions of the medium-term balance of payments projections.

Table 9. Ethiopia: Social Indicators

	Latest Single Year			Sub-Saharan Africa	Low-Income Countries
	1970-75	1980-85	1993-2001		
Population					
Total population, midyear (millions)	33.0	43.4	65.8	642.8	2,417.1
Growth rate (percent; annual average)	2.6	2.8	2.3	2.6	1.9
Urban population (percent of population) 1/	9.5	11.7	17.6	33.8	31.4
Total fertility rate (births per woman)	5.9	7.0	5.6	5.3	3.7
Income					
Gross National Income (GNI) per capita (U.S. dollars)	...	120	100	490	420
Consumer price index (1995/96=100) 2/	17	51	97	131	138
Food price index (1995/96=100) 2/	...	52	87	...	...
Income/consumption distribution					
Gini index 1/	...	...	40.0	...	...
Lowest quintile (percent of income or consumption) 1/	...	8.6	7.1	...	...
Highest quintile (percent of income or consumption) 1/	...	41.3	47.7	...	...
Public expenditure					
Health (percent of GDP) 3/	...	...	4.1	1.7	1.2
Education (percent of GNI) 3/	...	3.0	4.3	4.1	3.3
Social security and welfare (percent of GDP)	...	1.4	...	...	...
Net primary school enrollment rate (percent of age group)					
Total 1/	...	29	47	...	...
Male 3/	...	33	41	...	...
Female 3/	...	25	30	...	...
Access to safe water (percent of population)					
Total 1/	...	...	24	55	76
Urban 1/	...	...	77	82	88
Rural 1/	...	...	13	41	70
Immunization rate (percent under 12 months)					
Measles 4/	...	12	21	57	64
DPT 4/	...	6	27	59	70
Life expectancy at birth (years)					
Total	42	44	42	47	59
Male 1/	40	42	41	46	58
Female 1/	43	45	43	48	60
Mortality					
Infant (per thousand live births)	151	143	116	92	77
Under 5 (per thousand live births)	239	213	172	161	116
Adult (15-59)					
Male (per thousand of population) 1/	482	491	575	499	288
Female (per thousand of population) 1/	411	401	530	453	258

Source: World Bank, *World Development Indicators*, 2002; National Bank of Ethiopia.

1/ The numbers for the period 1993-2001 are as of 2000.

2/ The numbers for the period 1993-2001 are at end-2000/01.

3/ Latest available is as of 1998.

4/ Latest available is as of 1999.

July 22, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. In accordance with the provisions of the three-year arrangement (approved on March 22, 2001), under the Poverty Reduction and Growth Facility (PRGF), the government of Ethiopia, in cooperation with staff of the IMF, has evaluated the implementation of the second annual program (October 2001–September 2002) and performance through March 2003. The attached memorandum on economic and financial policies (MEFP) also presents the government's objectives and policies for the third annual program (July 2003–June 2004), in line with the strategy presented in Ethiopia's Sustained Development and Poverty Reduction Program of August 2002. The government intends to make the contents of this letter, and those of the attached MEFP and technical memorandum of understanding, available to the public and authorizes you to arrange for them to be posted on the IMF website, subsequent to Executive Board completion of the fourth review under the PRGF arrangement.

2. As you will appreciate, performance under the second annual program was broadly satisfactory, notwithstanding a severe drought, and continued deterioration of the terms of trade. Most quantitative and structural performance criteria and benchmarks through end-March 2003 were observed (see paragraph 4 of MEFP). The government is determined to meet all subsequent performance criteria and benchmarks. Following the completion of the fourth review under the PRGF arrangement by the Executive Board, the government requests the fifth disbursement of SDR 10.429 million under the arrangement. In view of the delay of the completion point under the enhanced HIPC Initiative by a few months compared to the original schedule of July 2003, the government is requesting additional interim enhanced HIPC assistance of SDR 2.111 million for the period November 8, 2003-May 31, 2004.

3. To monitor progress in economic policy implementation, financial and structural benchmarks through end-December 2003 and performance criteria for end-September 2003 under the third annual program are summarized in the tables annexed to the MEFP. The fifth review under the PRGF arrangement is scheduled to be completed by end-December 2003. At that time, the performance criteria for end-March 2004 will be established. The sixth and final review under the arrangement is scheduled to take place by end-July 2004. In order to complete this review the government of Ethiopia requests the extension of the PRGF arrangement to end-July 2004. The government will provide the IMF with such information as the IMF requests in connection with the country's progress in implementing the economic and financial policies and achieving the objectives of the program.

4. The government believes that the policies and measures set forth in the attached memorandum are adequate to achieve the objectives of the program. During the period of the arrangement, the government stands ready to take additional measures that may become appropriate for the achievement of the objectives of the program. We will consult with the Managing Director of the IMF on the adoption of any measures that may be appropriate, at the initiative of the government of Ethiopia or whenever the Managing Director requests such consultation. Moreover, after the period of the arrangement and while Ethiopia has outstanding financial obligations arising from loans under the arrangement, Ethiopia will consult the IMF from time to time at the initiative of the government of Ethiopia or whenever the Managing Director requests such consultation.

Sincerely yours,

/s/

/s/

Sufian Ahmed
Minister of Finance and
Economic Development

Teklewold Atnafu
Governor of the National Bank of Ethiopia

Attachments (2)

Memorandum of Economic and Financial Policies for the Period July 8, 2003-July 7, 2004
Technical Memorandum of Understanding

ETHIOPIA

Memorandum on Economic and Financial Policies for the Period

July 8, 2003 – July 7, 2004¹

July 22, 2003

I. BACKGROUND

1. The Government of Ethiopia reconfirmed its economic reform efforts and its commitment to poverty reduction within a framework of macroeconomic stability, as laid out in its interim Poverty Reduction Strategy Paper (IPRSP) of November 2000 and the Sustainable Development and Poverty Reduction Program (SDPRP) or full PRSP of August 2002. These reform efforts are supported by the International Monetary Fund under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement, approved on March 22, 2001. This memorandum reviews performance under the second annual program (October 2001 – September 2002) and during the period through March 2003, outlines the government's updated medium-term objectives and policy framework for 2003/04 – 2005/06, and sets out the economic and financial policies for 2003/04, within the strategy outlined in the SDPRP.

II. PERFORMANCE UNDER THE SECOND ANNUAL PROGRAM AND THROUGH MARCH 2003

2. Performance under the second annual program and through March 2003 has been broadly satisfactory, despite the adverse impact of a severe drought and continued deterioration of the terms of trade. Recent economic developments have been severely affected by the drought—the worst since 1984/85, with cereal production declining by about 6 percent in 2001/02 and 26 percent in 2002/03. An estimated 12.6 million people are in need of food assistance, compared with about 5 million in a normal crop year. Real GDP growth in 2001/02 was consequently revised downwards to 1.2 percent from 5 percent, and is estimated to have declined by 3.8 percent in 2002/03, mainly as a result of a drop in agricultural production and continued weakness in the world price of coffee, Ethiopia's major export. Average annual inflation accelerated to 13.4 percent in the 10-month period ending in April 2003, up from -7.2 percent in 2001/02, mainly because of food shortages. Food assistance needs for 2003 have been estimated at 1.5 million metric tons of cereals. So far, 1.3 million

¹ The fiscal year in Ethiopia starts on July 8.

metric tons have been secured and the government is seeking additional donor assistance to fill the gap. Timely arrival of pledged food aid is critical to ensure food security.

3. The external current account deficit (including official transfers) is estimated to have remained at around 6 percent of GDP in 2002/03 (excluding official transfers, the deficit rose from 13.2 percent to 15.2 percent). Total exports performed better than expected and are estimated to have increased by 8.6 percent, as the decline in coffee exports was more than offset by a robust growth of other exports. Coffee exports (which accounted for 37 percent of merchandise exports in 2001/02) have continued to decline largely because of a further drop in prices. Nonfactor service exports, however, grew strongly by over 14 percent. Large scale food aid imports, together with higher oil prices, resulted in an estimated increase of 16.5 percent in total imports in 2002/03. Non food, non fuel imports grew slightly faster than programmed reflecting progress with project implementation as well as higher prices.

4. All the quantitative performance criteria and benchmarks through December 2002 were observed (Table 1). The indicative quantitative targets for end-March 2003 were also met. The structural performance criterion related to the introduction of the value-added tax (VAT) was observed (Table 2), and a performance contract with the Commercial Bank of Ethiopia (CBE) was signed in June 2002 (structural benchmark). However, although progress was made with the help of the IMF technical assistance, the two structural benchmarks related to the improvement of public expenditure management have not yet been met, partly as a result of the ongoing decentralization of fiscal powers to *woredas* (districts). At end-September 2002, the nonperforming loans (NPLs) of the CBE (excluding cofinanced loans with the Development Bank of Ethiopia (DBE)) were only reduced to Birr 3.7 billion, compared to Birr 3.1 billion established as a structural benchmark.² Nonetheless, NPLs (including cofinanced loans) have fallen from their peak of Birr 5.8 billion at end-June 2002 to Birr 4.2 billion at end-March 2003 through write-off, the issuing of government bonds, foreclosure, rescheduling, and repayment. The audit of the CBE by an internationally reputable audit firm (KPMG), originally scheduled as a structural benchmark for January 2003, was eventually completed in early May 2003. During the same month a contract was signed with the Royal Bank of Scotland to begin providing management consulting services to the CBE for a two-year period, starting June 9, 2003 (prior action for the completion of the fourth PRGF review).

² NPLs of the CBE (excluding loans cofinanced with the Development Bank of Ethiopia) have been reduced to Birr 3.68 billion as of September 30, 2002, that is Birr 0.57 billion more than the benchmark, but down from Birr 5.01 billion on June 30, 2002. NPLs of the CBE rose considerably in the first half of 2002, following the arrest of a number of businessmen on charge of corruption. NPLs of the CBE as of December 2002 were Birr 3.45 billion.

5. In the fiscal area, the overall deficit (including grants) is estimated to have decreased from 9.3 percent of GDP in 2001/02 to 8.5 percent in 2002/03, compared with 9.7 percent under the program. However, excluding grants, the deficit is estimated to have widened from 14 percent of GDP to 17.4 percent (compared to 14.5 percent under the program), reflecting emergency assistance equivalent to 5.4 percent of GDP received in the form of grants.

6. On the revenue side, the government implemented several tax measures, including the introduction of the VAT (performance criterion) and the reduction of the average external import tariff from 19½ percent to 17½ percent in January 2003. The maximum tariff has been reduced from 40 percent to 35 percent, and the number of bands from seven to six. Efforts have also continued to improve tax administration and collection, including the strengthening of the large taxpayer unit, which accounts for about 75 percent of federal tax revenues. As a result, total tax revenues increased from 15.3 percent of GDP in 2001/02 to an estimated 16 percent in 2002/03.

7. On the spending side, the government continued to follow a cautious expenditure management policy, while making every effort to increase poverty-reducing spending. The government adopted a supplementary budget for 2002/03 in May 2003, to take account of additional external assistance in the form of grants from a bilateral donor and some additional nontax revenue, leading to higher spending of around 1.1 percent of GDP, mainly on a project aimed at extending access to education through the use of satellite technology. Defense expenditure was curtailed to 5.3 percent of GDP. However, poverty-targeted outlays (health, education, agriculture, and roads) are estimated to have increased to 17.7 percent of GDP, though somewhat lower-than-programmed because of delayed disbursement of external assistance. Total expenditures (including special programs) amounted to an estimated 39 percent of GDP and were higher than the level programmed by 2.7 percentage points of GDP, reflecting the high food aid received and lower than projected nominal GDP. Expenditures on special programs are estimated to have fallen from 1.9 percent of GDP in 2001/02 to 1.5 percent in 2002/03.

8. Regarding monetary and exchange rate policies, the government sterilized some excess liquidity and moved towards allowing greater market determination of the exchange rate. However, the financial market remains dominated by the CBE. Broad money is estimated to have increased by 11.3 percent in 2002/03 (compared with 12.4 percent assumed under the program, and 12.3 percent in 2001/02). Reflecting weak economic activity and the decision of the CBE to stop lending to those with NPLs, total credit to the nongovernment sector is estimated to have increased by only 4.8 percent, less than the 13.7 percent increase under the program, but compared with a decline by 7.1 percent in 2001/02. Credit to the government is estimated to have increased by 3.1 percent, in line with the program. Despite increased sales of government securities to the banking system, the banks' excess reserves rose from 8.1 percent of deposits on July 7, 2002 to 12.3 percent by end-March 2003 largely because of weak credit demand.

9. In the area of financial sector reforms, several measures were taken to strengthen the banking system and to improve the competitiveness of the financial sector, including the

adoption of a directive for the provisioning by banks for NPLs and troubled debt in line with international best practices in August 2002 (to be fully implemented by January 2004), and the signing of a performance contract with the CBE to ensure that the CBE is operated effectively on a commercial basis. The Construction and Business Bank (CBB) was brought to the point of sale through the floatation of 100 percent of shares to the Ethiopian public, but due to lack of audited accounts, the offer was withdrawn.

10. Since the beginning of the 2002/03 fiscal year, the nominal value of the birr has depreciated by about 0.2 percent against the dollar to reach Birr 8.6 per US dollar at end-March 2003. At end-March 2003, net foreign assets of the National Bank of Ethiopia (NBE) stood at US\$730 million (around 3.6 months of following-year imports of goods and services) compared with the programmed level of US\$521 million. Gross foreign reserves were estimated at around 4.6 months of following-year imports.

11. The government has implemented several other structural measures with World Bank assistance. These include expansion of health and education services, public sector management, including civil service reform and public expenditure policy, and private sector development. Several small public entities were brought to the point of sale in 2002, but the sale of larger public entities has proved more difficult, and only Birr 13 million is expected to be realized by end-2002/03.

12. During December 7-8, 2002, the Ethiopian government organized its first Consultative Group meeting since 1996 under the heading "Partnership for Accelerated and Sustainable Development". At that meeting, Ethiopia's development partners pledged US\$3.6 billion in support of the SDPRP over the three-year period 2002/03 – 2004/05. The government has also engaged the development partners in the harmonization of aid, including budget support, with the view to reducing the transaction costs related to aid delivery.

13. Ethiopia and Eritrea have exchanged prisoners of war (POWs) with Ethiopia releasing all Eritrean POWs in November 2002. The countries are currently discussing with the United Nations Mission to Eritrea and Ethiopia (UNMEE) the issue of the border demarcation between the two countries.

III. ALIGNING THE SDPRP AND THE PRGF AND MEDIUM-TERM STRATEGY

14. The third annual PRGF-supported program and the updated medium-term strategy were formulated in the context of the strategy outlined in the SDPRP (or full PRSP). The medium-term economic strategy focuses on promoting growth led by a strong performance of the agriculture and rural sectors, as well as by improving the environment for promoting exports and private sector growth. The strategy seeks to promote rapid, broad-based, and equitable growth by emphasizing rural development and improvement in physical and human capital in line with the SDPRP. In the context of this strategy, the PRGF-supported program focuses on six key policy components: (a) the reorientation of budgetary resources from defense toward poverty alleviation outlays; (b) improved public expenditure management in

the context of an overall reform of the public service and a decentralization of fiscal powers to the *woredas* (districts); (c) tax reforms that lay the foundation for a strong revenue performance; (d) improved monetary management and financial sector reform; (e) capacity building and regulatory reforms to promote private sector development; and (f) agricultural and rural development to ensure food security.

15. Taking into account the development strategy outlined in the SDPRP and the impact of the recent drought, and assuming a more realistic real GDP growth, the updated medium-term objectives for 2003/04-2005/06 would be (i) to achieve an annual average real GDP growth rate of about 6 percent (a 7 percent annual real GDP growth was projected in the SDPRP); (ii) to maintain core inflation at about 3 percent; and (iii) to reduce the external current account deficit (including official transfers and excluding aircraft imports of Ethiopian Airlines—see below) to about 4.9 percent of GDP (9.3 percent, excluding official transfers) by 2005/06.

IV. THE PROGRAM FOR 2003/04

16. The third annual program has been rephased to July 8, 2003- July 7, 2004, thus aligning it with the government's budget cycle, a key objective under the SDPRP. The program projects real GDP growth of 6.7 percent after the 3.8 percent decline in 2002/03, spurred by a gradual agricultural recovery following a two-year decline caused by the prolonged drought. An environment conducive to private sector development is expected to contribute to an increase in private investment to 9.8 percent of GDP. Consumer price inflation is projected to decline from an average of 14 percent in 2002/03 to 5.5 percent in 2003/04, as food supply conditions return to a more normal level and pledged food aid assistance is delivered on time. The external current account deficit (including official transfers and excluding aircraft imports for Ethiopian Airline (EAL)³) is projected to increase slightly from 6.1 percent of GDP in 2002/03 to 6.7 percent in 2003/04. Including EAL aircraft imports, the deficit would rise to 8.3 percent of GDP. Exports are expected to grow by 9.8 percent reflecting higher coffee prices and a recovery in volume, as well as continued strong performance of other exports. Imports would also continue to grow in response to both volume and price increases. Both private and official transfers are projected to fall from their drought related peak in 2002/03. Continued external support will allow a further build up in foreign reserve cover to 4.5 months of following year imports of goods and services (including EAL imports).

³ As part of the fleet expansion program, EAL will lease 12 new planes over the next three years. The planes will be delivered in three tranches starting in November 2003, July 2004, and July 2005, and will be financed by a \$350 million commercial loan to be repaid over 12 years. Under the terms of the PRGF arrangement, long-term financing operations of EAL are excluded from the program limit on new nonconcessional external debt contracted or guaranteed by the public sector.

A. Fiscal Policy

17. Fiscal policy will continue to focus on prudent public expenditure management and enhanced revenue mobilization. The Council of Ministers adopted on June 27, 2003 a budget for 2003/04 consistent with the fiscal framework presented in this MEFP. The overall fiscal deficit for 2003/04 (including grants, and special program expenditure equivalent to 1 percent of GDP) will be reduced from 8.5 percent of GDP in 2002/03 to 7.5 percent in 2003/04. The budget will be financed by net external financing (entirely on concessional terms) equivalent to 5.5 percent of GDP, as well as Birr 1 billion (1.6 percent of GDP) of domestic bank financing, Birr 162 million (0.3 percent of GDP) of non-bank finance, and projected receipts from privatization of about Birr 100 million (0.2 percent of GDP). In addition, the budget assumes grants equivalent to 8.5 percent of GDP to finance projects and emergency food aid.

18. The government is determined to pursue its tax reform efforts aimed at further improvement in revenue performance. To achieve the tax revenue target of 16.5 percent of GDP in 2003/04, revenue performance will benefit from the full-year impact of the VAT introduced in January 2003, and improved tax administration. The government will continue to implement the tax reform program, in particular the functioning of the large taxpayer unit, enhancing the activity of the tax reform task force, the computerization of the tax identification number (TIN) and of the VAT, while measures are also being put in place to collect tax arrears including strengthened enforcement powers and special units to deal with arrears. The Ministry of Revenue is also benefiting from IMF technical assistance in the area of customs administration.

19. The government will pursue a prudent expenditure policy, focusing on poverty-reduction activities identified in the SDPRP. Total outlays (including special programs and food emergency assistance) are targeted to decline to 36.7 percent of GDP in 2003/04. Food emergency assistance is projected at 1.4 percent of GDP. Defense outlays will be cut by 0.5 percentage points of GDP to 4.8 percent. Poverty-targeted spending will increase to 17.9 percent of GDP (including 1.3 percent from HIPC relief). The total wage bill is to be limited to 7.8 percent of GDP. Capital outlays are projected at 14.7 percent of GDP, taking into account only existing loan commitments from the World Bank and including planned spending on resettlement and water harvesting. Regarding future disbursements from the World Bank, in line with the Country Strategy Assistance (CAS), only grants shown in IDA's CAS for 2003/04, in addition to disbursements from already committed IDA loans, were included in the budget at this stage. At the time of the completion point, Ethiopia's debt sustainability will be reassessed and the amount of any additional debt relief will be determined. At that time, any additionally secured commitment of IDA loans will be added in a supplementary budget, provided that disbursements will be spent efficiently on poverty-related sectors and will not jeopardize macroeconomic stability or debt sustainability. Any additional HIPC assistance granted at the time of the completion point will also be included in the supplementary budget.

20. The government will continue to strengthen the budget management program and implement the action plan under the Country Financial Accountability Assessment (CFAA) aimed at further improvements in the country's accountability and transparency. In particular, the government will during 2003/04 (a) ensure that fiscal decentralization efforts go in parallel with budget planning by the Ministry of Finance and Economic Development; (b) develop a three-year rolling integrated plan for public expenditure management; (c) develop a road map and action plan for the introduction of a double entry modified cash system across the entire government; (d) introduce a suitable Integrated Financial Management System at the federal level; and (e) adopt capacity building initiatives at the regional and woreda level to support the devolution of budgetary and financial responsibility. The consolidation of federal and regional budgets for both the past year and the budget year—including all extrabudgetary funds and accounts—will be completed by end-November 2003 and efforts will be made to improve the effectiveness, reporting, and monitoring of local governments' expenditures, and address issues related to the decentralization of fiscal powers, particularly ensuring adequate fiscal reporting from *woredas*, identifying the cost of decentralization and of *woredas*' new employment structure, and ensuring clearly delineated and transparent responsibilities for capital spending within regions.

B. Monetary and Financial Sector Reform

21. Monetary policy will remain geared at achieving the inflation and international reserve targets under the program. To help achieve these targets while providing room for an adequate increase in credit to the nongovernment sector, the government will limit recourse to borrowing from the banking sector to Birr 1 billion to finance food security and drought-related spending in 2003/04. Money supply is projected to rise by about 13.4 percent in 2003/04. The government will continue sterilizing the excess reserves held by commercial banks. Interest rate policy will remain under review. All rates are market-determined, with the exception of saving deposit rate set at 3 percent. With core inflation at about 3 percent, interest rates presently in the range of 3-12 percent remain adequate. The exchange rate will continue to be market determined and the effectiveness of the interbank foreign exchange market will be strengthened.

22. The government attaches strong importance to reforms aimed at strengthening the financial sector and improving its competitiveness. Measures during 2003/04 will include (a) full provisioning by banks for NPLs and other doubtful assets in line with international best practices by January 2004; (b) finalizing the financial restructuring of the DBE by end-2003; and (c) taking steps to strengthen the NBE, following the completion of the ongoing comprehensive study of the NBE, including as necessary, revising the existing Banking Act to increase NBE's autonomy by end-2003. The issue related to the unaudited accounts of the CBB will be resolved and shares of that bank will be re-offered for sale to the Ethiopian public by end-September 2003 .

23. With respect to the CBE, an independent audit, carried out according to International Accounting Standards by KPMG, was finalized in May 2003. The audit found that (i) NPLs

amounted to Birr 5.8 billion (59 percent of total loans) at end-June 2002; and that (ii) the losses of CBE, after a one-off adjustment by the auditors (including for impaired-interest income), amounted to Birr 471 million in 2001/02, but the bank was very liquid. However, the audit also found that (i) the capital adequacy ratio was at 8.3 percent, higher than the minimum required level of 8 percent; and that (ii) the recommended level of loan loss provisions against the advances portfolio was Birr 2.4 billion, representing an increase in the provisions held by the bank at end-June 2002 of Birr 273 million. Finally, the audit recommended that the NPLs issue be addressed, actions taken to restore the profitability of CBE, and that credit risk and portfolio management be significantly strengthened. As noted earlier, at end-March 2003 NPLs were reduced to Birr 4.2 billion (49 percent of total loans as per unaudited accounts), and provisions were raised to Birr 2.4 billion, higher than what is required by the NBE provisions directives.

24. The authorities will finalize, adopt, and commence implementing by end-November 2003 a detailed financial restructuring plan to restore CBE's profitability. The objective of this plan is to ensure that CBE becomes a sound and profitable bank. The plan will be based on the KPMG audit. Measures are being taken to minimize the risk of new NPLs emerging. The measures that have been implemented include (a) ceasing all lending to borrowers with NPLs; (b) strengthening the credit approval and monitoring process for all new loans; (c) transferring lending authority from the board of CBE to its management; (d) giving autonomy to management in decision making; (e) creating an audit committee at the board to oversee financial performance; and (f) implementing the revised foreclosure law to speed up its application and improve its effectiveness. Moreover, as part of the restructuring plan of CBE, credit risk and portfolio management will be significantly strengthened. The key elements of the plan will include (i) ensuring that CBE complies fully with the NBE provisioning directives by January 2004; (ii) a time-bound plan for reducing NPLs to 20 percent of total loans; and (iii) ensuring that the capital adequacy ratio will not fall below the minimum required ratio of 8 percent, and promptly recapitalizing the bank should the ratio fall below 8 percent. In addition, as part of the restructuring plan, the modalities and timetable for resolving NPLs will be set out clearly, no annual dividends will be paid out by the CBE until the capital adequacy ratio reaches at least 10 percent, and a business plan will be prepared to achieve this target by June 2004. The key actions that CBE will carry out in the period ahead will include (i) starting the preparation of the detailed restructuring plan, which would also address the advisability and modalities of establishing an asset management company; and (ii) completing an annual audit for the financial statement as at end-June 2003. The draft detailed restructuring plan of CBE will be submitted to the Monetary and Financial Systems Department (MFD) of the IMF for comments before it is finalized. To this end, an MFD mission, or preferably a joint MFD/World Bank mission, will go to Ethiopia to discuss such plan when it is ready, including how to reduce large loan exposures. An assessment of the fiscal impact of the restructuring plan, if any, will be carried out at that time.

25. The government will continue its efforts to enhance efficiency and competition in the financial sector, to prepare the ground for the progressive integration of the Ethiopian financial sector into the global financial market. Efforts are being made to strengthen private

and public banks through creating a favorable external environment for banking, strengthening the internal dynamics of banks, and fostering contestability of markets within the banking sector. Banks are being encouraged to modernize and raise efficiency by adopting improved practices and building their capacities, through a rigorous application of the revised bank provisioning directive, and more autonomous bank management, that is made more accountable to its board of directors. To enhance competition, private banks are being encouraged to increase their scale of operation and raise their capital base, including through mergers. The authorities will continue to foster the development of microfinance institutions by transforming them into rural banks and by facilitating the flow of funds from commercial banks to those institutions for the purposes of on-lending.

C. External Sector and Financing Requirements

26. The government projects an increase in the external current account deficit (including official transfers and excluding aircraft imports by EAL) to 6.7 percent of GDP in 2003/04. This will be fully covered by project loan disbursements, balance of payment support from the AfDB (US\$26 million), World Bank balance of payments support grant (US\$150 million), reconstruction and demobilization programs (US\$74 million), and by assistance under the enhanced HIPC Initiative (US\$91 million). Such external financial assistance should allow further accumulation of international reserves to the equivalent of 4.7 months of following year imports. Over the medium term, the current account deficit (including transfers and excluding aircraft imports by EAL) is projected to decline to 4.9 percent of GDP (6.3 percent including EAL imports) by 2005/06, as a result of continued growth of nontraditional and traditional exports and nonfactor services. At the same time, total import growth is expected to decline, reflecting lower food aid requirements. Sustained concessional lending together with debt relief under the HIPC Initiative will allow maintenance of foreign exchange reserves at around 4.6 months of imports.

27. The government remains committed to trade liberalization in the context of the frameworks of the Common Market for Eastern and Southern Africa (COMESA), which has been chaired by Ethiopia in the past year. A new Investment Code was passed in April 2003 to promote foreign investment. Under the new code, the sole operation by government has been reduced to the transmission and distribution of electricity in main national lines, postal services excluding fast postal service, and aircraft that transport over 20 passengers. In addition, Ethiopia is conducting a Diagnostic Trade Integration Study (DTIS) as a preliminary step in the Integrated Framework for Trade Development in the Least Developed Countries. In this regard a National Steering Committee for the DTIS chaired by the Minister of Trade and Industry and including a few bilateral partners as well as IMF and World Bank representatives has been constituted. The purpose of the DTIS is to identify key constraints to the country's integration into the multilateral trade system and the global economy.

28. Following the Paris Club meetings on April 5, 2001 and April 12, 2002, the government has signed bilateral agreements with all but two Paris Club creditors, and the last two agreements are being finalized. It is also seeking rescheduling of debt owed to non-Paris Club creditors on terms at least comparable to those given by the Paris Club, and consistent

with assumptions under the HIPC Initiative. Additional debt relief provided beyond that assumed under the Initiative has also financed additional poverty-targeted expenditure. Due to practical difficulties in implementing the mechanism agreed at the HIPC decision point for disbursing and tracking payments from the HIPC account at the NBE, the government will agree with creditors on a simplified method for disbursement that ensures that such resources continue to be spent in a timely manner on poverty-related activities, and which is consistent with the government's monitoring systems, including the Public Expenditure Review.

29. External debt sustainability analysis will be updated later in the year at the time of the completion point. Preliminary estimates indicate, however, that the NPV of debt-to-export ratio has risen sharply since the HIPC decision point in November 2001, largely due to exogenous factors. Application of updated exchange rates, discount rates, and export prices to the debt stock assumptions at the decision point increases the NPV debt-to-export ratio in 2003/04 from 174 percent to well over 200 percent. In this regard, the government intends to continue following sound debt management policies by restricting new borrowing to concessional credits, while simultaneously exploring with development partners the possibility of increasing the grant element in external assistance. In addition, the government will closely monitor new concessional borrowing and ensure that foreign loans are used effectively to enhance growth, particularly of exports.

30. The government will rely on prudent macroeconomic policies and a market-determined flexible exchange rate to maintain the current account in line with the prospective availability of foreign grants, concessional loans, and debt relief. With regard to new borrowing, the public sector will neither contract nor guarantee any new external loans on nonconcessional terms. New external debt incurred by Ethiopian Airlines will be excluded from these limitations. There will be no accumulation of external arrears at any time.

31. During the program period, the government will not introduce or intensify any existing exchange restrictions, introduce or modify any multiple currency practices, conclude any bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, or introduce or modify import restrictions for balance of payments purposes. Furthermore, the authorities intend to eliminate the few remaining exchange restrictions that existed prior to the PRGF arrangement, and accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. In addition, following the completion of the study of the NBE the authorities will speed up the implementation of the recommendations made in the recent Safeguards Assessment of the NBE.

D. Social Policies, PRSP, and HIPC

32. The government will continue to implement the SDPRP and prepare a progress report on the first year of implementation of the program by the time of the next PRGF review. The progress report will include (i) a further articulated strategy for promoting private sector development, including agriculture; (ii) alternative macroeconomic scenarios, as well as an examination of the linkages among macroeconomic policies, structural reforms, and poverty; (iii) a refinement of costing of PRSP programs, and (iv) an evaluation of the early experience

with fiscal decentralization. Following some delay in the preparation of the terms of reference for the poverty and social impact analysis of the introduction of the VAT, the study has commenced and its findings as well as those from a separate study on the impact of the decline in coffee prices will be incorporated in the progress report. With regard to meeting the remaining enhanced HIPC Initiative completion point triggers, the reconciliation of fiscal and monetary accounts will be completed by end-December 2003 with further Fund technical assistance. Difficulties encountered in the consolidation of federal and regional budgets are largely resolved and the consolidated budgets for 2002/03 and 2003/04 will also be prepared by end-November 2003. The government expects to achieve all the triggers for the HIPC Initiative Completion Point by end-2003.

E. Other Structural Reforms

33. With the assistance of the World Bank and bilateral donors the government will continue to implement structural reforms that are conducive to growth and poverty reduction, including agricultural reform, food security, capacity building, export promotion, strengthening of the existing legal and regulatory framework, and supporting private sector development. In the area of export promotion, the government will continue to support the textile, horticulture, and leather subsectors with land, credit, and other facilities. To maintain export proceeds in the face of declining international prices, the government will make strong efforts to market organic and gourmet coffee while ensuring that the removal by the NBE of the floor on coffee exports prices benefits the producer. The government will continue to support the already established public-private sector consultation which is facilitated by the Ministry of Trade and Industry with the establishment of additional sectoral and sub-sectoral partnerships. Moreover, the privatization program will be enhanced. In April 2003, the government adopted an industrial development strategy document, and a white paper was issued.

F. Statistical Issues

34. With the support of technical assistance from AFRITAC, an action plan will be adopted to improve the compilation of real sector and balance of payments data. With regard to the revision of monetary statistics and the coverage of international reserves, comments on draft formats and manuals have been received from commercial banks and implementation will commence in July 2003. The meta data for Ethiopia under the GDDS has been updated and posted on the IMF Bulletin board since November 2002.

G. PRGF Monitoring

35. The program will be monitored on the basis of (a) quantitative quarterly performance criteria and benchmarks, which are set out in Table 3, and described fully in the attached technical memorandum of understanding; and (b) structural performance criteria and benchmarks, as specified in Table 4. The Macroeconomic Technical Committee will continue to meet regularly, with the IMF's resident representative in attendance, and report

monthly to the Minister of Finance and Economic Development on progress made in the implementation of the program.

36. As indicated in the cover letter of intent addressed to the Managing Director of the IMF, two reviews are envisaged under the program; the fifth review will be based on economic performance at end-September 2003, to be completed by December 2003, and the sixth review will take place six months thereafter.

Table 1. Ethiopia: Quantitative Benchmarks and Performance Criteria for the Second Annual Program Supported by the PRGF Arrangement, July 7, 2001-March 2003 1/
(In millions of birr, unless otherwise indicated)

	2001			2002									2003		
	July 7	July 7		September			December			March					
	Actual (Stock)	Benchmark	Adjusted Benchmark	Actual	Indicative Targets	Perf. Crit. 2/	Adjusted Perf. Crit.	Actual	Benchmark 3/	Adjusted Benchmark	Actual	Indicative Targets	Adjusted Target	Actual	
I. Quantitative benchmarks and performance criteria															
Floor on net foreign assets of the National Bank of Ethiopia 4/ 5/	1,619	1,159	731	2,532	1,230	-177	-166	536	551	700	1,860	551	508	2,018	
Ceiling on net domestic assets of the National Bank of Ethiopia 6/ 7/	7,361	-334	94	-1,050	-371	163	151	-306	199	49	-1,301	446	489	31	
Ceiling on net domestic financing of the general government (incl. privatization receipts) 7/ 8/ 9/	17,313	400	828	-87	-371	0	-11	-321	-280	-430	-1,281	400	443	-612	
Ceiling on outstanding external payments arrears (in million of US\$) 10/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Ceiling on new nonconcessional external debt contracted or guaranteed by the public sector 11/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
II. Indicative target															
Floor on net foreign liquid reserves of the National Bank of Ethiopia 4/ 5/	1,155	1,159	731	2,436	1,230	-177	-166	497	551	700	1,858	551	508	2,163	
III. Triggers for adjustment of quantitative benchmark and performance criteria															
Disbursed nonproject external funding (in million of U.S. dollars) 12/	...	423	312	312	168	42	43	43	200	218	218	259	249	249	

Source: Ethiopian authorities.

1/ For 2001/02, cumulative flows from July 8, 2001. For 2002/03, cumulative flows from July 8, 2002. Program exchange rate of 8.524 Birr/USD used.

2/ Established as performance criteria in the context of the third review.

3/ Established as benchmarks in the context of the third review.

4/ Adjusted upward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 12 of the Technical Memorandum (TM) dated December 2001).

5/ Adjusted downward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (done for December 2001 and March 2002; paragraph 15 of the TM dated December 2001).

6/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 13 of the TM dated December 2001).

7/ Adjusted upward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (done for December 2001 and March 2002; paragraph 15 of the TM dated December 2001).

8/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 14 of the TM dated December 2001).

9/ Stock at July 7, 2001 reflects domestic government borrowing, but excludes privatization receipts.

10/ There shall be a continuous performance criterion on the nonaccumulation of new external arrears.

11/ This limit applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the IMF on August 24, 2000, but also to commitments contracted or guaranteed for which the value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines.

12/ Excluding fertilizer projects.

Table 2. Ethiopia: Structural Benchmarks and Performance Criteria Under the Second Annual Program Supported by the Three-Year PRGF Arrangement

Structural Benchmarks and Performance Criteria	Timing
Adopt regulation for the provisioning by banks for nonperforming loans and other doubtful assets in line with international best practices, taking into account Basel Committee guidelines for troubled debt restructuring and credit risk.	March 31, 2002 (Done) 1/ (structural benchmark)
Submit to the NBE's Board an unqualified audit of NBE's financial statements carried out by the Audit Services Corporation for the year ended June 30, 2001.	March 31, 2002 (Done) (performance criterion)
Sign a performance contract with the CBE to ensure that the CBE is operated effectively on a commercial basis to achieve the necessary improvements in financial performance.	June 30, 2002 (Done) (structural benchmark)
Reduce nonperforming loans of the CBE by Birr 0.8 billion (from Birr 3.9 billion at end-December 2001), including through write-offs.	September 30, 2002 2/ (structural benchmark)
Consolidate federal and regional budgets for both the past year and the budget year—including all extrabudgetary funds and accounts.	September 30, 2002 3/ (structural benchmark)
Reconcile monetary and fiscal accounts.	December 31, 2002 (revised) 3/ 4/ (structural benchmark)
Introduce the value-added tax, as adopted by Parliament on July 4, 2002.	January 1, 2003 (Done) (performance criterion)
Complete the audit of the CBE by a reputable international audit firm.	January 31, 2003 5/ (structural benchmark)

1/ A first directive was adopted on March 30, 2002, but was revised on August 31, 2002 to bring it more fully in line with international best practice.

2/ NPLs of the CBE (excluding loans cofinanced with the Development Bank of Ethiopia) have been reduced to Birr 3.68 billion as of September 30, 2002, that is Birr 0.57 billion more than the benchmark, but down from Birr 5.01 billion on June 30, 2002. NPLs of the CBE rose considerably in the first half of 2002, following the arrest of a number of businessmen on charge of corruption. NPLs of the CBE as of December 2002 were Birr 3.45 billion.

3/ Progress in consolidating budgets, and reconciling monetary and fiscal accounts were delayed partly because of the on going decentralization process.

4/ Initial date was September 30, 2002. The authorities will request further technical assistance to complete the benchmarks.

5/ The award of the contract was delayed due to procedural problems related to contract award. The CBE audit was awarded to KPMG in mid-January 2003 and its work started in early February. The (draft) audit was completed in early May 2003.

Table 3. Ethiopia: Quantitative Benchmarks and Performance Criteria for the Third Annual Program Supported by the PRGF Arrangement, March, 2003-March, 2004 1/
(In millions of birr, unless otherwise indicated)

	2003				2004
	March Actual (Stock)	July 7 Estimate (Stock)	September Perf. Crit. 2/	December Benchmark 3/	March Indicative Targets 4/
I. Quantitative benchmarks and performance criteria					
Floor on net foreign assets of the National Bank of Ethiopia 5/ 6/	6,273	6,047	-136	-283	712
Ceiling on net domestic assets of the National Bank of Ethiopia 7/ 8/	6,342	6,961	319	370	-336
Ceiling on net domestic financing of the general government (incl. privatization receipts) 8/ 9/ 10/	16,777	17,813	269	460	-236
Ceiling on outstanding external payments arrears of the public sector (in million of US\$) 11/	0	0	0	0	0
Ceiling on new nonconcessional external debt contracted or guaranteed by the public sector 12/	0	0	0	0	0
II. Indicative target					
Floor on net foreign liquid reserves of the National Bank of Ethiopia 5/ 6/	5,838	5,467	-136	-283	712
III. Triggers for adjustment of quantitative benchmark and performance criteria					
Disbursed nonproject external funding (in million of U.S. dollars) 13/	249	313	37	74	261

Source: Ethiopian authorities.

1/ For 2003/04, cumulative flows from July 8, 2003. Program exchange rate of 8.5937 Birr/USD used.

2/ Established as performance criterion in the context of the fourth review.

3/ Established as a benchmark in the context of the fourth review.

4/ Established as an indicative target in the context of the fourth review.

5/ Adjusted upward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 12 of the Technical Memorandum (TM) dated July 2003).

6/ Adjusted downward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (paragraph 15 of the TM dated July 2003).

7/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 13 of the TM dated July 2003).

8/ Adjusted upward for 50 percent of any shortfall in programmed external assistance (nonproject, excluding enhanced HIPC interim assistance) up to a maximum of US\$50 million (paragraph 15 of the TM dated July 2003).

9/ Adjusted downward for external assistance (nonproject, excluding enhanced HIPC interim assistance) that exceeds programmed amounts (paragraph 14 of the TM dated July 2003).

10/ Stocks at March 31, 2003 and July 7, 2003 reflect domestic government borrowing, but excludes privatization receipts.

11/ There shall be a continuous performance criterion on the nonaccumulation of new external arrears.

12/ This limit applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the IMF on August 24, 2000,

but also to commitments contracted or guaranteed for which the value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines.

13/ Excluding fertilizer projects.

Table 4. Ethiopia: Prior Actions and Structural Benchmarks and Performance Criteria Under the Third Annual Program Supported by the Three-Year PRGF Arrangement

Prior Actions, Structural Benchmarks, and Performance Criteria	Timing
Completing the audit of the CBE by a reputable international audit firm.	May 15, 2003 (Done) (prior action)
Hiring a reputable international management consultant to help the CBE operate effectively on a commercial basis and improve its financial performance.	May 30, 2003 (Done) (prior action)
Adoption by the Council of Ministers of a budget for fiscal year 2003/04 consistent with the fiscal framework presented in the letter of intent.	June 27, 2003 (Done) (prior action)
Finalization and adoption of a financial restructuring plan by the government for the CBE that includes (i) ensuring that CBE complies fully with the NBE provisioning directives by January 2004; (ii) a time bound plan for reducing NPLs to 20 percent of total loans; (iii) ensuring that the capital adequacy ratio will not fall below the minimum required ratio of 8 percent, and promptly recapitalizing the bank should the ratio fall below 8 percent; and (iv) not paying annual dividends until the capital adequacy ratio reaches at least 10 percent.	end-November, 2003 (performance criterion)
Consolidate federal and regional budgets for both the past year and the budget year—including all extrabudgetary funds and accounts.	end-November 2003 (performance criterion)
Reconcile monetary and fiscal accounts.	end-December 2003 (structural benchmark)
Finalization of a restructuring plan for the NBE, based on the recent KPMG study, and beginning of its implementation.	end-December, 2003 (structural benchmark)
Full provisioning by all commercial banks for nonperforming loans and other doubtful assets in line with the existing NBE directive.	end-January 2004 (structural benchmark)

ETHIOPIA

Technical Memorandum of Understanding

July 22, 2003

I. INTRODUCTION

1. This memorandum sets out the understandings between the Ethiopian authorities and staff of the International Monetary Fund (IMF) regarding the definitions of quantitative and structural performance criteria and benchmarks, as well as indicative targets, for the third annual program under the three-year arrangement supported by the Poverty Reduction and Growth Facility (PRGF), as well as the mechanisms to monitor the program and related reporting requirements. To monitor the evolution of the economy during the program period, the Ethiopian authorities will provide the data listed in each section below to the African Department of the IMF, in accordance with the indicated timing. The financial criteria will be monitored on the basis of the methodological classification of monetary and financial data that exists as of end-May 2003. For program purposes, the public sector consists of the general government (comprising the federal and regional governments) and the National Bank of Ethiopia (NBE). The quantitative targets for end-September 2003 constitute performance criteria, and those at end-December, 2003 are benchmarks. The indicative benchmarks for end-March 2004 will be established as performance criteria in the context of the fifth review to be completed by end-December 2003.

II. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS: DEFINITIONS AND REPORTING STANDARDS

A. Floor for Net Foreign Assets (NFA) of the NBE

2. **Definition.** The NFA of the NBE are defined as the difference between gross international reserves and all foreign liabilities of the NBE, including debts to the IMF and other long- and short-term liabilities to nonresidents of the NBE. Foreign liabilities also include foreign-currency-denominated domestic liabilities of the NBE. For calculating the criteria, foreign assets and liabilities shall be valued at the U.S. exchange rates prevailing at end-May 2003. Gold holdings will be valued at the U.S. dollar market price at end-May 2003. Finally, the net foreign assets shall be converted into local currency at the exchange rate at end-May 2003 (8.5937 birr per U.S. dollar).¹ Performance relative to an indicative floor on the net foreign liquid reserves of the NBE will also be monitored.²

¹ The program exchange rate.

² This aggregate consists of unencumbered gross reserves and foreign-currency-denominated liabilities of the NBE, excluding donor funds in transit.

3. **Reporting.** Data on gross international reserves and foreign liabilities of the NBE will be transmitted to the African Department of the IMF through the Fund Resident Mission on a weekly basis within ten days of the end of each week. The NBE will also report the breakdown between liquid and unencumbered gross international reserves and those reserve assets that are pledged, swapped, or encumbered.

B. Ceiling on Net Domestic Assets (NDA) of the NBE

4. **Definition.** The NDA of the NBE are defined to include net credit to the government, credit to enterprises and individuals, claims on banks, and other items net, but exclude foreign currency valuation adjustments.

5. **Reporting.** The monthly balance sheets of the NBE will be transmitted within six weeks of the end of each month.

C. Limit on the Net Domestic Financing of the General Government

6. **Definition.** The net domestic financing requirement of the general government is defined as the sum of (i) the change in the stock of general government domestic (bank and nonbank) debt; (ii) domestic and foreign receipts from divestiture operations, net of related expenditures; (iii) any pending overdue bills;³ and (iv) the floating debt.⁴ Net bank claims on general government consist of NBE and commercial bank claims on the government, including treasury bills and other government liabilities, net of general government deposits with the NBE and commercial banks. Nonbank claims comprise treasury bills, bonds, and other general government paper placed with nonbank institutions or with the public.

7. **Reporting.** Data on domestic financing (bank and nonbank) of the general government (including treasury bills and government bonds held by the nonbank public) will be transmitted on a monthly basis, within six weeks of the end of each month, except for the data on regional governments, which will be furnished within eight weeks after the end of each month. Net divestiture receipts, with gross receipts broken down into domestic and foreign currency, will be reported on a monthly basis, within six weeks of the end of each

³ Overdue bills are defined as bills pending for payment beyond 30 days after a request for payment authorization has been made (i.e., pending for a period that exceeds the normal commercial grace period). These bills constitute either domestic or external payments arrears (including also arrears on external debt service except for pending payments related to debt subject to debt relief). At end-May 2003, there were no overdue bills reported.

⁴ For the purposes of program monitoring, floating debt of the general government is defined as the sum of (i) the stock of accrued expenditures (payment authorization requests) for which payments orders have not been issued; and (ii) the stock of payment orders issued but not encashed.

month. Reporting on domestic and external arrears (i.e., overdue bills) will be monthly, within six weeks of the end of each month.

D. Ceiling on External Payment Arrears

8. **Definition.** External payment arrears are defined as overdue debt service arising in respect of obligations incurred directly or guaranteed by the public sector, except on debt subject to rescheduling or restructuring. The program requires that no new external arrears be accumulated at any time under the arrangement.

9. **Reporting.** The accounting of nonreschedulable external arrears by creditor (if any), with detailed explanations, will be transmitted on a monthly basis within four weeks of the end of each month. This accounting would include, separately, arrears owed by the federal government and other public sector entities; arrears owed by Ethiopian Airlines; and arrears owed to Paris Club creditors, non-Paris Club creditors, and other creditors. Data on other arrears, which are reschedulable, will be provided separately.

E. Ceiling on Nonconcessional External Debt

10. **Definition.** External debt limits apply to the contracting or guaranteeing of nonconcessional external debt by the public sector or any other agencies on behalf of the public sector.⁵ External debt includes all current liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time to discharge the principal and/or interest liabilities incurred under the contract. This definition includes loans, suppliers' credits, and leases (operational and financial leases). Concessionality will be based on a currency-specific discount rate based on the ten-year average of the OECD's commercial interest reference rates (CIRR) for loans or leases with maturities greater than 15 years and on the six-month average CIRR for loans or leases maturing in less than 15 years. Under this definition of concessionality, only debt with a grant element equivalent to 35 percent or more will be excluded from the debt limits.

11. **Reporting.** A loan-by-loan accounting of all new concessional and nonconcessional loans contracted or guaranteed by the public sector, including detailed information on the amounts, currencies, and terms and conditions, as well as relevant supporting materials, will be transmitted on a quarterly basis within four weeks of the end of each quarter.

⁵ This limit applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by the IMF on August 24, 2000 (see Annex) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this limit are short-term import credits and long-term financing operations of Ethiopian Airlines.

III. ADJUSTERS

A. Excess in Disbursed External Financial Assistance

12. In case of an excess external financing beyond the programmed amounts shown in Table 3 annexed to the memorandum on economic and financial policies (MEFP) for the period July 8, 2003-July 7, 2004, the floor on net foreign assets of the NBE will be adjusted **upward** (with two exceptions), by the amount of disbursed external financing **in excess** of the programmed amounts (comprising non-project-related loans and grants, including special programs, but excluding interim debt relief under the enhanced HIPC Initiative) at the end of each quarter (Table 3 annexed to MEFP), valued at the average exchange rate of the quarter. The two exceptions are (i) an amount of up to US\$50 million in excess of programmed overall external financing can be spent on special programs in the case that the overall excess funding stems from higher than programmed financing of the special programs; and (ii) an amount of up to US\$50 million in excess of programmed overall external financing can be spent on poverty-targeted outlays if the excess stems from higher than programmed other non-project financing. Accordingly, within this limit, the floor on net foreign assets, and the ceilings on net domestic assets of the NBE, and domestic financing of the general government will not be adjusted.

13. The ceiling on net domestic assets of the NBE will be adjusted **downward** (with the two above-mentioned exceptions) by the amount of disbursed external financing **in excess** of the programmed amounts (comprising non-project-related loans and grants, including special programs, but excluding interim debt relief under the enhanced HIPC Initiative) at the end of each quarter (Table 3 annexed to MEFP), converted into birr at the average exchange rate of the quarter.

14. The ceiling on domestic financing of the general government will be adjusted **downward** (with the two above-mentioned exceptions) by the amount of external financing disbursed to the budget **in excess** of the programmed amounts (comprising non-project-related loans and grants, including special programs, but excluding interim debt relief under the enhanced HIPC Initiative) at the end of each quarter (Table 3 annexed to MEFP), converted into birr at the average exchange rate of the quarter.

B. Shortfall in External Financial Assistance

15. In case of a shortfall in external financing below the programmed amounts, (comprising non-project-related loans and grants, including special programs, but excluding interim debt relief under the enhanced HIPC Initiative) shown in Table 3 annexed to the MEFP:

- The floor on the NFA of the NBE will be adjusted **downward** by a maximum of 50 percent of the amount of the shortfall below the programmed amount, but by no more than US\$50 million. The adjustment will be converted at the average exchange rate of the quarter.

- The ceiling on the NDA of the NBE will be adjusted **upward** by a maximum of 50 percent of the amount of the shortfall, but by no more than US\$50 million. The adjustment will be converted into birr at the average exchange rate of the quarter.
- The ceiling on general government net domestic financing will be adjusted **upward** by a maximum of 50 percent of the amount of shortfall in external financial assistance disbursed to the budget, but by no more than US\$50 million. The adjustment will be converted into birr at the average exchange rate of the quarter.

IV. OTHER REPORTING REQUIREMENTS FOR PROGRAM MONITORING

A. Macroeconomic Monitoring Committee

16. The macroeconomic monitoring committee, composed of senior officials from the Ministry of Finance and Economic Development, the NBE, and other relevant agencies, shall meet regularly and be responsible for monitoring the performance of the program, recommending policy responses, informing the IMF regularly about the progress of the program, and transmitting the supporting materials necessary for the evaluation of performance criteria and benchmarks. The committee shall provide the IMF with a progress report on the program on a monthly basis within four weeks of the end of each month, using the latest available data.

B. Developments on Structural Performance Criteria and Benchmarks

17. The authorities will notify the African Department of the IMF of developments on structural performance criteria and benchmarks as soon as they occur. The authorities will provide the documentation, according to the dates in Table 3 annexed to the MEFP, elaborating on policy implementation.

C. Data Reporting

Production and prices

18. The following data shall be transmitted:
- The monthly disaggregated Addis Ababa consumer price index will be transmitted within four weeks of the end of each month.
 - The national consumer price index and its regional components will be transmitted within eight weeks of the end of each month.
 - Any revisions to the national accounts data will be transmitted within three weeks of the date of the revision.

Public finance

19. Monthly data on public finance will require a consolidated budget report of the federal and regional governments comprising:

- the revenue data by each major item, including that collected by the Federal Inland Revenue Authority, the Customs Office, and the regional governments;
- details of the recurrent and capital expenditure of the federal and regional governments; and
- details of budget financing, domestic, and external data will be transmitted within six weeks of the end of each month and data of the regional governments within eight weeks of the end of the month.

Monetary sector data

20. The following data will be transmitted on a daily/weekly/biweekly basis within one/five working days of the end of each day/week:

- treasury bill auction details (rates, amounts, and holders); and
- interbank foreign exchange rates and transactions.

21. The balance sheet of the NBE and the consolidated balance sheets of the commercial banks will be transmitted on a monthly basis within six weeks of the end of each month. The stocks of government securities, detailed information on interbank money market transactions (terms, duration, and participating institutions), and interest rate developments will be transmitted on a monthly basis within two weeks of the end of each month.

External sector data

22. The following data will be transmitted as follows:

- The interbank market exchange rate, as the simple average of the daily-weighted average buying and selling rates, will be transmitted on a weekly basis within five business days of the end of the week.
- Exports, imports, and other balance of payments data on services, private transfers, and capital account transactions will be transmitted on a quarterly basis within six weeks of the end of each quarter.
- The Ethiopian authorities will provide IMF staff regularly with detailed monthly data on the volume and prices of imported petroleum products and exports of coffee.

- The Ethiopian authorities will consult with IMF staff if balance of payments developments endanger the achievement of program objectives.

Ethiopia: Relations with the Fund

(As of May 31, 2003)

I. Membership Status: Joined 12/27/1945; Article XIV

II. General Resources Account	SDR Million	Percent of quota
Quota	133.70	100.00
Fund Holdings of Currency	126.52	94.63
Reserve position in Fund	7.19	5.38

III. SDR Department	SDR Million	Percent of allocation
Net cumulative allocation	11.16	100.00
Holdings	0.06	0.49

IV. Outstanding Purchases and Loans	SDR Million	Percent of quota
Structural Adjustment Facility (SAF)	6.35	4.75
Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF)	94.06	70.35

V. Latest Financial Arrangements

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR million)</u>	<u>Amount Drawn (SDR million)</u>
PRGF	03/22/2001	03/21/2004	100.28	68.99
ESAF	10/11/1996	10/22/1999	88.47	29.49
SAF	10/28/1992	11/08/1995	49.42	49.42

VI. Projected Obligations to Fund Under the Repurchase Expectations Schedule

	Forthcoming; in SDR million				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	3.6	8.7	5.9	7.6	12.3
Charges/interest	0.4	0.7	0.6	0.6	0.5
Total	4.0	9.4	6.5	8.2	12.8

VII. Implementation of HIPC Initiative

Commitment of HIPC assistance	Enhanced Framework
Decision point date	Nov. 2001
Assistance committed (NPV terms) ¹	end-2000/01
Total assistance by all creditors (US\$ Million)	1,275

¹NPV terms at the decision point under the enhanced framework.

<i>Of which:</i> IMF Assistance (SDR Million)	26.93
Completion point date	Floating
Delivery of Fund assistance (SDR Million)	
Amount disbursed	8.16
Interim assistance	8.16
Completion point	0.00
Amount applied against member's obligations (cumulative)	6.67

VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the National Bank of Ethiopia (NBE) is subject to a full safeguards assessment with respect to the Poverty Reduction and Growth Facility arrangement approved on March 22, 2001, which is scheduled to expire on March 21, 2004. An off-site safeguards assessment of the NBE was completed on May 4, 2001. The assessment concluded that high risks may exist in financial reporting and in the system of internal controls and recommended an on-site assessment. The on-site assessment was completed on September 12, 2001. The staff's findings and recommendations are reported in Appendix V of EBS/02/37 (3/4/02).

IX. Exchange Rate Arrangement

Effective October 24, 2001, NBE terminated the weekly wholesale foreign exchange auctions for the birr (Br) and moved all foreign exchange operations to the interbank market. The current exchange rate regime is classified as managed floating. The transaction-weighted average interbank market exchange rate on May 31, 2003 was Br 8.5937 = US\$1.

In March 2001, the authorities eliminated previously existing restrictions on the purchase of foreign exchange for holiday travel and education purposes. Since then, exporters have been allowed to retain 10 percent of their export proceeds in foreign exchange for an indefinite period. The rest may be retained for a period of 28 days, after which it has to be converted into local currency by the customer's bank using the prevailing transaction rate, unless an exporter spends it on eligible imports within 28 days. The multiple currency practice that might have arisen from the NBE's weekly foreign exchange auction was lifted with the replacement of the auction by the interbank foreign exchange market. However, a few current account exchange restrictions that existed prior to the PRGF arrangement remain with respect to Article VIII, Sections 2, 3, and 4 of the IMF's Articles of Agreement. These restrictions relate to (a) the tax certification requirement for repatriation of investment income; (b) restrictions on repayment of legally entered into external loans and supplies and foreign partner's credits; (c) rules for issuance of import permits; and (d) the requirement to provide a clearance certificate from NBE to obtain import permits.

X. Article IV Consultation

Ethiopia is on the 24-month cycle for members with Fund arrangements in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on September 23, 2002, concurrently with the completion of the third review under the second annual PRGF-supported program (EBS/02/158).

XI. Technical Assistance (2000-present)

Department	Purpose	Time of Delivery
FAD	Tax administration (resident expert)	May 1999-July 2001
STA	Consumer price index	March-April 2000
FAD	Introduction of VAT, presumptive income tax, and reform of the income tax	August 2000
FAD	Tax administration	October 2000
MAE	Monetary and banking reforms	October 2000
FAD/LEG	Tax administration and VAT legislation	January-February 2001
MAE	Monetary and banking reforms	February-March 2001
FAD	Tax administration	April 2001
MAE	Bank supervision	April-May 2001
MAE	Monetary and banking reforms	May 2001
MAE	Interbank foreign exchange market	June-July 2001
LEG	Income tax legislation	September 2001
FAD	Tax administration	September-November 2001
MAE	Bank supervision	September-October 2001
LEG	Review of compliance with Article VIII	November 2001
STA	Consumer price index	November-December 2001
STA	Multisector	January 2002
MAE	Bank supervision	February 2002
FAD	Tax administration	February 2002
STA	Fiscal and monetary accounts	May 2002
LEG	VAT law	May 2002
MAE	Payment system	May-June 2002
FAD	Public expenditure management	July 2002
FAD	Tax administration	July 2002
MAE	Accounting and internal audit of central bank	August 2002
FAD	Tax administration	November 2002
MAE	Accounting and internal audit of central bank	November-December 2002

XII. Resident Representative

Mr. Alexander Kyei assumed the post in August 2001.

Ethiopia: Relations with the World Bank (As of June 2003)

A. Partnership in Ethiopia's Development Strategy

1. In July 2002, the government of Ethiopia finalized its full Poverty Reduction Strategy Paper (PRSP) or Sustainable Development and Poverty Reduction Program (SDPRP). This was endorsed in September 2002 by the Boards of the World Bank and the Fund, along with a Joint Staff Assessment of the SDPRP strategy.
2. The IMF has taken the lead in helping Ethiopia maintain macroeconomic stability, under a three year Poverty Reduction and Growth Facility (PRGF) arrangement approved in March 2001. The PRGF addresses issues related to fiscal consolidation and structural reforms that are key to maintaining macroeconomic stability and fostering growth. The PRGF's structural conditionality has focused on the following areas: the financial sector, budget consolidation and reconciliation, taxation, and public expenditure management.
3. The Bank leads the policy dialogue on structural reforms relevant to economic growth and poverty reduction, including rural development, infrastructure, private sector development (PSD), human development, governance, and vulnerability. Bank and Fund share joint responsibility in supporting financial sector, taxation, decentralization, and public expenditure reforms. The Bank and the Fund have jointly assisted the Government in the preparation of the SDPRP and are providing assistance for its implementation, as well as for reaching the HIPC Completion Point, scheduled for end-2003 or early 2004.

B. Key Areas of Common Interest to Bank and Fund

4. Preparation of the PRSP. The World Bank and the IMF have collaborated in providing support to the government in the preparation of the PRSP, including by preparing joint comments on an early draft of the PRSP and the Joint Staff Assessment.
5. Through lending and analytical work, the Bank and the Fund jointly support policy reforms, including the following main areas:
6. Macroeconomic policy and the financial sector. There is close cooperation between the World Bank and the IMF in discussing macroeconomic policy with the government. Complementing the PRGF's focus on macroeconomic issues, the Bank's forthcoming Poverty Reduction Support Credit (PRSC) will focus on structural policy reforms to support pro-poor growth. Priority results sought under the PRSC are likely to include; (a) an improved investment climate; (b) improved financial sector performance; (c) better infrastructure provision; (d) more efficient institutions supporting private sector development, and (e) more efficient domestic input and output markets. The World Bank and IMF will also cooperate closely on macro 'Economic and Sector Work' (ESW) where the Bank is analyzing the requirements for a pro-poor growth macroeconomic framework, and investigating policy instruments to address macro and fiscal volatility.

7. Public sector reforms. The Bank and Fund have been supporting the Government's movement towards decentralization with a view to improving the workings of the civil service and improving service delivery at the local level, particularly in terms of improving the incentives for regional and local level performance in the formula for sub-national transfers of public resources. The Bank and Fund have also worked closely with the Government on taxation policy and reforms.

8. Public expenditure management. (i) *Public Expenditure Review.* The Fund has been an active participant in Bank-coordinated annual public expenditure reviews, which have provided an objective analysis of the government's public expenditure strategy, as well as an opportunity to study issues in public finance management of common interest and concern. The 2001 PER was the first review of public expenditure at the regional level. The 2002 PER will focus on (a) spending in the social sectors; and (b) an update on overall spending patterns, budget systems issues, and fiscal decentralization developments. (ii) *Institutional and Governance Review.* In the future, in addition to looking at expenditure composition and expenditure tracking with the Fund in the context of a planned annual joint Government-donor budget review, the Bank will increasingly deal with institutional issues in expenditure management through an Institutional and Governance Review (IGR), working closely with AFRITAC. (iii) *Tracking Poverty-Reducing Public Spending.* In the context of HIPC, the government, IDA and the IMF are tracking the use of savings arising from HIPC interim assistance.

9. Debt sustainability analysis and the Enhanced HIPC Initiative. At the time of the HIPC Decision Point in November 2001, the World Bank and the Fund closely collaborated on conducting a debt sustainability analysis (DSA). In preparation for the recent CAS, the World Bank and the Fund, together with the Government of Ethiopia, updated the DSA to assess the impact on debt sustainability of additional disbursements envisaged under the CAS. The DSA will be revised as Ethiopia reaches HIPC Completion Point.

10. Statistical issues. Both institutions have been providing technical assistance to the government of Ethiopia on the compilation of data and statistics, with the Fund focusing on the compilation of macroeconomic statistics and the Bank supporting the improvement of data on poverty and social indicators, and on the monitoring of output and outcomes of poverty reduction programs.

C. Bank Group Strategy

11. The World Bank has aligned its Country Assistance Strategy (CAS) for FY03-FY05 (July 8-July 7) with SDPRP objectives. The CAS was produced with the Government in consultation with other key stakeholders. As part of the consultation process, workshops were held on three key themes; (i) capacity building (March 2002), (ii) decentralization and service delivery (May 2002), and (iii) private sector development and pro-poor growth (July 2002).

12. The CAS - which was discussed by the Executive Board of the World Bank on April 17th - envisages new Bank commitments of around US\$1.5 billion in the base case, with up to 40% provided in grants under IDA13. However, due to debt sustainability

concerns, the Bank is holding back the full scale of lending until a decision is made on the amount of debt relief which Ethiopia will receive at Completion Point under the Enhanced HIPC Initiative. The new CAS proposes a shift away from more traditional project-based lending to programmatic approaches, including a PRSC.

13. World Bank support to the SDPRP is framed round three inter-related objectives:

- Enhancing pro-poor growth;
- Enhancing human development outcomes by improving governance;
- Reducing vulnerability.

14. The CAS also assigns particular importance to infrastructure development. Priority emphasis in approaching these objectives is placed on the three key themes covered during the consultation process, i.e. capacity building, decentralized service delivery, and private sector development.

15. Capacity building. In October 2001, the government unveiled a comprehensive five-year National Capacity Building Program (NCBP), comprising 14 components, to rapidly build capacity in support of second-generation reforms aimed at promoting pro-poor growth, deepening democratic decentralization, and improving service delivery at the national, regional, and local levels. Over the CAS period, the Bank is supporting the government program with a pilot activity on public sector capacity building for decentralization, and plans to scale this up in the shape of a Public Service Delivery and Capacity Building Program (PSCAP). Other sectoral capacity building projects (e.g. information and communication technology (ICT), rural, civil society) are also envisaged.

16. Decentralization and service delivery. In pursuit of its poverty reduction objectives, the government sees decentralization as the principal means to make governance and resource allocation responsive to citizens' needs and preferences. Accordingly government has chosen to further deepen the process of decentralization, by granting greater responsibility to the sub-national governments for the provision of primary education, primary health, rural water, and rural roads; and by allocating untied block grants to *woredas* (Districts) to facilitate this. Through the new CAS, the Bank will help finance decentralized public services through the PRSC and a Decentralized Infrastructure Fund, while the PSCAP program will support implementation capacity.

17. Private sector development. The Bank is working with the government to identify and implement actions which remove obstacles to private sector development. The forthcoming PRSC is expected to focus, inter alia, on financial market development, improving competitiveness and exports, improving the overall investment climate, and improving the workings of rural markets, rural credit and technology transfer.

18. As of 10 June 2003, Ethiopia's portfolio of IDA credits comprised 19 active projects, with total commitments of US\$ 1,765million and an undisbursed balance of US\$ 904 million. This compares with 14 projects, commitments of US\$1,382 million, and an undisbursed amount of US\$946 million at the beginning of 1999/2000.

Ethiopia: Statistical Issues

Real sector

1. The authorities have improved the timeliness and coverage of national accounts, economic surveys, and prices since 1993. Preliminary national accounts are available through 2001/02 (July 8-July 7). A new series of GDP estimates, using a 1999/2000 base period instead of the 1995/96 base period in the original plan, is under construction and is expected to be released shortly. With the assistance of a number of STA missions, a new consumer price index (CPI) has recently been released, consisting of a national index and 11 regional indices, which have replaced the old urban and rural indices. In addition, the base period has been updated to December 2000, using data from the Household Income, Consumption, and Expenditure Survey of 1999/2000.

Public finances

2. Monthly federal government accounts are reported with a six- to eight-week lag. The consolidated general government (federal and regional) accounts are reported once a year. The ongoing devolution of budgetary authority to regional governments has further eroded the quality and the timeliness of the general government accounts, owing to the lack of a unified accounting framework. The coverage of government finance statistics is incomplete (it excludes extrabudgetary funds, namely, the privatization, road, fuel stabilization, and sugar auction funds), and there are discrepancies between data on the domestic and foreign financing of the budget deficit and the monetary accounts. The Ministry of Finance and Economic Development (MOFED) and the National Bank of Ethiopia (NBE) established a joint reconciliation committee, which issued a set of recommendations to synchronize the recording of fiscal and monetary data, broaden the scope of institutional coverage, and improve the classification of accounts; however, the process of reconciling fiscal and monetary accounts has been delayed owing to technical problems.

Monetary accounts

3. The monetary survey is comprehensive and normally reported with a six-week lag. An STA technical assistance mission in January 2002 found that Ethiopia's money and banking statistics are broadly adequate for policy and analytical purposes, although their quality is compromised by various methodological problems. The mission recommended correcting classification problems in the resident sector with the accounting data and establishing a separate identification of nonperforming assets. Regarding international reserves, the mission recommended that the NBE limit its coverage to liquid foreign assets only. Finally, based on its examination of the draft version of the new report form, the mission recommended that the NBE introduce the new report form without delay.

Balance of payments

4. Balance of payments data still require improvements in the coverage, valuation, timing, and classification of transactions. The authorities have begun working toward the adoption of the fifth edition of the *Balance of Payments Manual*, but problems persist. In particular, key surveys recommended by the 1995 STA mission for the collection of basic data were not carried out until early 1999/2000. Import data still rely primarily on exchange control data, even though the quality of that data has worsened in the wake of the exchange system liberalization in 1998. The use of customs records to generate trade data has begun with the operationalization of the Automated System for Customs Data (ASYCUDA) at major customs stations in February 1999, which should improve the timeliness and coverage of trade statistics. An export unit value index is available (with a two-year delay), but no import unit value index is produced. Data on official and private transfers and private capital flows are also weak. The NBE, in collaboration with the Ethiopia Investment Authority and other government agencies, is preparing a database on foreign direct investment, including a reporting system for tracking new investment. The January 2002 multisector mission recommended methods for improving the quality of the data on tourism, insurance, foreign direct investment, private transfers, and private debt. However, to date, STA has not received any information from the authorities on progress made in the implementation of these recommendations.

Social indicators

5. Data on poverty exist in the form of several household surveys regularly conducted by the Central Statistical Authority (CSA).¹ In addition, the World Bank has produced reports on Education and Health Sector Development Programs, as well as the Poverty and Policies for the New Millennium Report (1999), that contain data on the poverty situation in Ethiopia. On the basis of this information, the government, with assistance from the World Bank, has constructed welfare indicators for measuring poverty reduction, including income and expenditure per capita, income inequality, literacy, malnutrition, and infant/child mortality measures. Adequate data do not exist on prevalence rates of HIV/AIDS, especially among the rural population, and it is not clear whether there is sufficient monitoring of food consumption among people living in drought-prone areas.

¹ Examples of existing surveys include the Household Income, Consumption, and Expenditure Survey (1995/96 and 1999/2000) and the Welfare Monitoring Survey (1996, 1997, 1998, and 1999). Additional household and consumption surveys were carried out by the University of Addis Ababa in collaboration with Oxford University.

Ethiopia: Survey of Reporting of Main Statistical Indicators
(As of June 30, 2003)

	Exchange Rates	Net Foreign Assets of the Banking System	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates ¹	Consumer Price Index (CPI)	Exports and Imports ²	Current Account Balance	Overall Federal Government Balance	GDP	External Debt/Debt Service
Date of latest observation	May 31, 2003	March 2003	March 2003	March 2003	March 2003	March 2003	May 2003	March 2003	March 2003	March 2003	2001/02	March 2003
Date received	June 6, 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003	June 2003
Frequency of data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Monthly	Annual	Quarterly
Frequency of reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Monthly	On mission	On mission
Source of data	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	National Bank of Ethiopia	Central Statistical Authority	National Bank of Ethiopia	National Bank of Ethiopia	Ministry of Finance	Ministry of Finance and Economic Development	Ministry of Finance and Economic Development
Mode of reporting	On mission	On mission	On mission	On mission	On mission	On mission	On mission	On mission	On mission	On mission	On mission	On mission
Frequency of publication	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Annually	Annually	Irregularly
Confidential	No	No	No	No	No	No	No	No	No	No	No	No

¹ Savings and time deposits and lending rates. Yields on treasury bills at the auction are reported every two weeks, with the latest data as of June 12, 2002.

² Export and import data are based on customs records.



International Monetary Fund

[Search](#)

[About the IMF](#) | [IMF at Work](#) | [IMF Finances](#) | [Country Info](#) | [News](#) | [Publications](#)

Press Releases for
[2003](#) [2002](#) [2001](#) [2000](#)
[1999](#) [1998](#) [1997](#) [1996](#)
[1995](#)

Press Release No. 03/145
August 28, 2003

International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

[Ethiopia and the IMF](#)

[The IMF's Poverty
Reduction and
Growth Facility
\(PRGF\) -- A
Factsheet](#)

**E-Mail
Notification**
Subscribe
or
Modify
your
subscription

IMF Completes Review Under Ethiopia's PRGF Arrangement and Approves US\$14.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the fourth review of Ethiopia's performance under a Poverty Reduction and Growth Facility (PRGF) Arrangement. As a result, Ethiopia will be able to draw up to SDR 10.429 million (about US\$14.3 million) under the arrangement immediately. It further extended the period of the arrangement, which was due to expire on March 20, 2004, through July 2004.

The Board also approved a request for additional interim HIPC assistance for SDR 2.111 million (about US\$2.9 million) for the period November 8, 2003-May 31, 2004.

Ethiopia's PRGF arrangement was approved on March 22, 2001 (see [Press Release No. 01/11](#)) for SDR 86.9 million (about US\$119 million). On March 18, 2002, the Board increased the PRGF arrangement by SDR 13.38 million (about US\$18 million) to help mitigate the impact on the balance of payments of a continued deterioration of the terms of trade and the events of September 11. So far, Ethiopia has drawn SDR 68.99 million (about US\$94.5 million).

The PRGF is the IMF's concessional facility for low income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period.

After the Executive Board's discussion on Ethiopia, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

"Recent economic performance has been seriously affected by a severe drought in 2002, the worst in many years. As a result of the drought and a sharp drop in cereal production, real GDP declined in

2002/03, and food prices rose markedly. An estimated 12.6 million people are in need of food assistance.

"Despite this shock, Ethiopia's performance during the second annual program was broadly satisfactory. All the quantitative performance criteria and benchmarks through December 2002, as well as the indicative targets for end-March 2003, were observed. In particular, the introduction of the value-added tax was carried out in January 2003, a performance contract was signed with the Commercial Bank of Ethiopia (CBE) in June 2002, and an audit of the CBE by independent auditors was completed in May 2003, after a delay of four months. The ongoing decentralization of fiscal powers to woredas (local districts), however, contributed to delays in the implementation of structural benchmarks (and HIPC Initiative completion point triggers) related to the improvement of public expenditure management.

"The overall fiscal deficit (including grants and emergency programs) is estimated to have declined slightly from preceding years. Several tax measures were implemented (including the introduction of the value-added tax and the reform of the import tariff regime). Defense expenditure was contained at 5.3 percent of GDP, while poverty-related expenditure rose to 17.7 percent in 2002/03. Further progress was made in improving the soundness of the financial sector, including the adoption of a directive to ensure provisioning for nonperforming loans in line with international best practices, while, interest and exchange rate policies remain appropriately flexible and market-determined.

"The policies to be implemented under the third annual program aim at maintaining macroeconomic stability and achieving rates of economic growth that are sufficient to reduce poverty. In 2003/2004, real GDP growth, spurred by a recovery in agricultural output, is projected to rise to 6.7 percent. With food supply conditions returning to a more normal level, consumer price inflation is projected to decline, while the external current account deficit is expected to increase slightly.

"Fiscal policy in the period ahead will focus on achieving and maintaining public debt sustainability, while maximizing the use of highly concessional resources for poverty reduction activities. The overall deficit (including grants and special program financing) is expected to narrow further to 7½ percent in 2003/04. Implementation of the tax reform program will continue, including measures to collect tax arrears and strengthen the large taxpayer unit. Defense spending will be reduced to 4.8 percent of GDP, while poverty-related spending will be increased further to about 18 percent of GDP. The ongoing decentralization of fiscal authority to local districts will be closely monitored.

"Attention will continue to focus on strengthening the financial sector. In particular, a detailed restructuring plan will be developed for the CBE to restore its profitability and sound management, and measures will be taken to strengthen the finances, independence, and supervisory capacity of the National Bank of Ethiopia. Other structural reforms to be pursued include initiatives to improve food security, promote microfinance institutions, and enhance the climate for private investment," Mr. Sugisaki stated.

IMF EXTERNAL RELATIONS DEPARTMENT
Public Affairs: 202-623-7300 - Fax: 202-623-6278
Media Relations: 202-623-7100 - Fax: 202-623-6772

[IMF Home](#) [What's New](#) [Site Map](#) [Site Index](#)
[About the IMF](#) [IMF at Work](#) [IMF Finances](#) [Country Info](#) [News](#) [Publications](#)
[Terms and Conditions](#) [Privacy Policy](#)