

**LAPSE OF
TIME**

EBS/21/49

June 2, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **The Federal Democratic Republic of Ethiopia—Request for an Extension of the Arrangement Under the Extended Credit Facility**

Board Action:	Executive Directors' consideration on a lapse of time basis
Deadline to Request Board Meeting:	Wednesday, June 9, 2021 12:00 (noon)
Proposed Decision:	Page 5
Publication:	Yes*
Questions:	Ms. Jain-Chandra, AFR (ext. 35881) Mr. Giri, AFR (ext. 34567) Mr. Leichter, AFR (ext. 36177) Mr. Saborowski, AFR (ext. 36436) Mr. Versailles, AFR (ext. 39820)

*The authorities have indicated that they consent to the Fund's publication of this paper.



THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

June 1, 2021

REQUEST FOR AN EXTENSION OF THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

Approved By
**David Robinson (AFR) and
Delia Velculescu (SPR)**

Prepared by the African Department (In consultation
with other departments)

1. The Ethiopian authorities request an extension of the date on which the arrangement under the Extended Credit Facility (ECF) will terminate to September 19, 2021. The three-year ECF-EFF arrangements were approved on December 20, 2019 for a combined amount of SDR 2.1 billion (700 percent of quota). Total access was reduced to SDR 1.9 billion (650 percent of quota; of which 400 percent under ECF and 250 percent under EFF) on April 30, 2020 to comply with the Fund's annual access limit policies at the time of approval of SDR 300.7 million (100 percent of quota) in emergency assistance via the Rapid Financing Instrument (RFI). The ECF arrangement is set to expire automatically on June 19, 2021, since no program review would have been completed during the 18 months period since the ECF arrangement was approved by the Executive Board.¹

2. The first two reviews of the ECF-EFF arrangements have yet to be completed, pending assurances for a debt reprofiling to reduce the risk of debt distress to moderate by the end of the program, in line with the PRGT exceptional access policy. A staff-level agreement to conclude the first and second reviews of the ECF-EFF was reached on February 23, 2021. However, the authorities have been pursuing debt reprofiling with official bilateral creditors and await the receipt of financing assurances from creditors consistent with the program's parameters to allow for the completion of the reviews. Such assurances are required to reduce the risk of debt distress to moderate by the end of the program, thereby strengthening Ethiopia's

¹ Section II, paragraph 1(b)(4) of the Poverty Reduction Growth Trust instrument annexed to [Decision No. 8759-\(87/176\) ESAF](#), as amended, states "An ECF arrangement for a member approved after the date of adoption of this decision will automatically terminate before its term if no program review under the arrangement has been completed over a period of eighteen months. The Trustee, at the authorities' request, may decide to delay the termination of the arrangement by up to three months in cases where the reaching of understandings between the authorities and the Trustee on targets and measures to put the ECF-supported program back on track within the term of the arrangement, appears imminent. The ECF arrangement will automatically terminate at the end of the extended period unless a program review under the arrangement is completed within this period."

debt sustainability and the safeguards for the Fund as required by the PRGT exceptional access policy. After initially seeking such assurances on a bilateral basis from key creditors, the authorities requested a comprehensive and durable debt treatment under the G20 Common Framework in early February 2021. They have since engaged closely with the Secretariat on technical grounds and have hired financial and legal advisors to assist them in the process.

3. Ethiopia continues to battle COVID-19 while ethnic-related tensions have increased ahead of the June elections, creating a need for humanitarian interventions. The Ethiopian authorities determinedly addressed the fallout from the initial wave of the pandemic—including through a 1.6 percent of GDP fiscal package in a second 2019/20 supplementary budget—allowing for a cautious reopening of the economy in the second half of 2020. However, since late-January 2021 another surge in infections is underway with daily cases in April surpassing the earlier peak reached in August 2020. Meanwhile, localized pockets of violence persist in Tigray, and there are reports of continued presence of Eritrean troops. The international community has expressed serious concerns about reported atrocities and the humanitarian crisis. Access for delivery of essential items has improved since the early months of the conflict but remains challenging. In addition, the government announced a joint investigation with the UN into alleged war crimes. Inter-ethnic tensions in other regions have led to additional security challenges. National elections, scheduled for early June, have been delayed to June 21 to provide time to address logistical challenges.

4. The authorities continue to implement the program notwithstanding these challenges. The implementation of the program supported by the ECF-EFF arrangements has been promising except at the height of the pandemic in mid-2020. Nearly all quantitative targets for the December 2019 test date were met. With the onset of the pandemic, most June 2020 quantitative performance criteria (QPCs) were missed, as the authorities appropriately relaxed their fiscal and monetary policies to address the pandemic. Most December 2020 indicative targets (ITs) were met. Most structural benchmarks (SBs) early in the program were met, while performance thereafter was mixed. The authorities also completed important reforms that had not been expected at the time of program approval.

- **Quantitative targets for December 2019 test date.** All QPCs and ITs were met except for the continuous QPC on the non-accumulation of new external arrears which was breached due to delayed payments resulting primarily from issues with inter-agency coordination.² The authorities took corrective actions and cleared all delayed payments by March 2020 and have not accumulated any new external arrears since.
- **Quantitative targets for June 2020 test date.** Several quantitative targets were missed as the authorities responded to the health and economic impact of the COVID-19 crisis. These include the QPCs on net financing of the general government primary balance, reserve money and net international reserves, and the IT on tax collections.

² See [IMF Country Report No. 20/150](#) (footnote 1) for details.

- **December 2020 ITs.** The authorities met all ITs set at program approval except reserve money—which, as a stock measure, was missed because the end-June slippage was carried forward—and the IT on claims on public enterprises.
- **Structural Benchmarks (SBs).** Three of the four SBs to be completed by end-April 2020 were met, with the SB on publishing a consolidated financial performance report for 20 SOEs being the exception. Of the four additional SBs scheduled for completion by end-June 2020, the SB on the publication of the assessment of tax expenditures and the SB on the publication of financial statements for CBE and DBE were not met, although both actions have now been completed (in addition, the revenue measures under the June fiscal revenue SB were subsequently not fully implemented due to the pandemic). The September 2020 SB on a review of subsidies and the December 2020 SB on an audit to uncover payment arrears were not met, including due to capacity constraints arising from the pandemic. The authorities have requested IMF technical support for a review of all subsidies on energy products. The April 2021 SB on completing an AQR for CBE was also not met, although the AQR is ongoing.
- **Accountability and transparency of COVID-related measures.** The authorities have met most of their commitments under the April 2020 RFI and are on track to meet the remaining ones. Tenders for major public contracts were carried out through competitive bidding and published online. A directive was issued to ensure that all mobilized (both donor and own) resources are accounted for. Monitoring of COVID spending is led by a steering committee chaired by the deputy Prime Minister. An ex-post audit by the Auditor General covering COVID-19 related measures during FY2019/20 is underway and is expected to be completed and published by September 2021.
- **Other.** In addition to the reforms on which understandings were reached at the arrangements' approval, the authorities adopted a comprehensive and transparent plan to restore debt service capacity for a set of SOEs that account for more than 90 percent of total domestic SOE debt, as well as a roadmap outlining a transition to an interest rate based monetary policy framework. They have also increased reliance on T-bill issuance in financing the budget deficit more rapidly than envisaged at the time of program approval (allowing them to reduce central bank financing) and proceeded with T-bill yield curve development. The nominal exchange rate depreciated by 42 percent as of March 2021 relative to October 2020 (prior to program approval), which delivered a 14 percent REER depreciation.³ The authorities have received bids for two telecom operator licenses and have made progress on the partial privatization of EthioTelecom, although the process was delayed by the pandemic.

5. The authorities remain committed to the ambitious reform agenda under the Homegrown Economic Reform Plan supported by the ECF-EFF arrangements. They have outlined their commitments in the attached Letter of Intent. The main objectives remain to address

³ The REER gap assessed at program approval was 25 percent on average for the fiscal year 2018/19, which implies a gap of some 37 percent in October 2019, assuming an unchanged equilibrium exchange rate.

external imbalances—including by correcting real exchange rate overvaluation and eliminating the gap with the parallel market—reduce debt vulnerabilities by containing borrowing by the broader public sector and debt service relief, raise domestic revenues including to help increase social spending, tighten monetary conditions to reduce inflation, make progress on phasing out financial repression, modernize the monetary policy framework, develop financial markets, streamline the FX regulatory framework, and encourage private sector-led growth.

6. The proposed three-month delay in the automatic termination of the ECF arrangement would enable reaching revised understandings on targets and measures, which would allow completing the pending reviews.⁴ As noted above, a staff-level agreement on policies and targets for the reviews was reached in February, including in the areas of the foreign exchange market, the monetary policy framework, the financial sector, SOE reforms, and reforms to raise tax revenues. The proposed extension of the ECF arrangement can provide time to make any necessary modifications. Moreover, given that the delays in completing the program reviews have affected the timing of donor support, the additional time will also be used to engage in discussions with donors and with the authorities on the 2021/2022 budget. Finally, the proposed extension allows more time for creditors to engage under the G20 Common Framework and provide the financing assurances needed to achieve a moderate risk of debt distress rating by the end of the program.

7. Staff supports the authorities' request for a three-month extension in the automatic termination of the ECF arrangement to September 19, 2021 as reaching revised understandings between the authorities and staff on targets and measures, which would allow completing the pending reviews, appears imminent. The extension is expected to provide the additional time needed to receive the required financing assurances for a debt treatment under the Common Framework.

⁴ These understandings would put the ECF-supported program back on track. A Fund-supported program is considered off track *inter alia* when reviews are not completed on time. In the case of the Ethiopia ECF-EFF arrangements, a staff-level agreement for the completion of the first and second reviews was reached in February 2021, but the reviews were not completed due to the absence of financing assurances for a debt reprofiling needed to allow for a moderate risk of debt distress rating by the end of the program.

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. In a letter dated May 27, 2021 from the Minister of Finance and the Governor of the National Bank of Ethiopia, the Federal Democratic Republic of Ethiopia has requested that the automatic termination of its arrangement under the Extended Credit Facility (EBS/19/122, Supplement 3) (the "ECF Arrangement"), set to take place at the end of June 19, 2021, be delayed for a period of three-months which will allow enough time to reach understandings on policies that enable completion of pending reviews under the ECF Arrangement.
2. The Executive Board decides, in accordance with Section II, paragraph 1(b)(4) of the PRG Trust, to delay the automatic termination of the ECF Arrangement through the end of September 19, 2021. Accordingly, the ECF Arrangement will automatically terminate at the end of this date if no review under the arrangement is completed within this period.

Table 1. The Federal Democratic Republic of Ethiopia: Quantitative Performance Criteria and Indicative Targets, December 2019–December 2020

(All figures in millions of Ethiopian birr, unless otherwise specified)

	end-June	end-Sep	end-Dec 2019			end-Mar 2020				end-Jun 2020				end-Sep 2020				end-Dec 2020				
	2019	2019	Program target	Adjusted	Actual	Status	Indicative target	Adjusted	Actual	Status	Program target	Adjusted	Actual	Status	Indicative target	Adjusted	Actual	Status	Indicative target	Adjusted	Prel.	Status
Quantitative performance criteria																						
Net financing of the general government primary balance (ceiling, cumulative change, includes grants and excludes interest payments) ^{1/ 2/ 3/}	54,642	16,104	33,561	33,704	12,537	✓	50,341	50,605	25,299	✓	67,121	67,072	79,796	✗	16,596	16,821	5,972	✓	33,192	33,432	32,764	✓
Net international reserves (floor, cumulative change, US\$ millions) ^{2/}	3,134 ^{7/}	-789	-636	-780	-531	✓	-157	-422	-1,226	✗	21	21	-962	✗	32	-194	22	✓	137	-103	-77	✓
Reserve money outstanding (ceiling)	200,749 ^{7/}	186,801	199,815	199,815	197,050	✓	212,829	212,829	222,722	✗	225,843	225,843	246,545	✗	233,937	233,937	261,353	✗	242,031	242,031	258,707	✗
Continuous performance criteria																						
Contracting or guaranteeing of external non-concessional debt by the general government, the NBE or public enterprises (ceiling, US\$ millions) ^{4/}			0	0	0	✓	0	0	0	✓	0	0	0	✓	0	0	0	✓	0	0	0	✓
Accumulation of external payment arrears by the government or the NBE (ceiling, US\$ millions) ^{4/}			0	0	210	✗	0	0	0	✓	0	0	0	✓	0	0	0	✓	0	0	0	✓
Indicative targets																						
Claims on public enterprises by commercial banks (ceiling, cumulative change) ^{2/ 3/}	424,327 ^{7/ 8/}	8,499	25,127	25,127	12,975	✓	49,644	49,644	71,238	✗	74,161	74,161	73,574	✓	14,581	14,581	14,881	✗	29,162	29,162	35,880	✗
Tax revenue collected by the federal government (floor, cumulative change) ^{2/}	194,265	55,781	81,589	81,589	124,718	✓	163,178	163,178	178,896	✓	244,792	244,792	228,454	✗	56,358	56,358	61,910	✓	112,750	112,750	145,913	✓
Net claims on the general government by the NBE (ceiling, cumulative change) ^{2/}	143,620 ^{7/ 8/}	7,608	10,905	10,905	-12,046	✓	15,178	15,178	19,214	✗	19,450	19,450	7,328	✓	2,871	2,871	-4,862	✓	5,743	5,743	-9,987	✓
Contracting or guaranteeing of external concessional debt by the general government, the NBE or public enterprises (ceiling for the fiscal year ending June, US\$ millions) ^{4/ 5/ 9/}			1,825	1,825	0	✓	1,825	1,825	331	✓	1,825	1,825	1,064	✓	2,100	2,100	165	✓	2,100	2,100	165	✓
Productive Safety Net Programme cash transfers (floor, cumulative change) ^{2/ 4/}	13,976 ^{8/}	3,886	2,330	2,330	8,154	✓	6,365	6,365	13,792	✓	11,082	11,082	17,954	✓	1,601	1,601	5,040	✓	3,593	3,593	5,680	✓
Memorandum items																						
Official external grants disbursed to the government (US\$ millions, cumulative) ^{2/}	1,199	194	485	...	529	...	728	...	857	...	970	...	1,297	...	217	...	169	...	435	...	488	...
Official external loans disbursed to the government (US\$ millions, cumulative, excluding RFI onlending) ^{2/}	1,461	199	776	...	588	...	1,163	...	770	...	1,551	...	1,273	...	338	...	161	...	675	...	382	...

Sources: Ethiopian authorities and IMF staff estimates and projections.

1/ Excluding through on-lending from the general government.

2/ Cumulative change from July.

3/ Excludes commercial bank claims related to Addis Ababa Housing credit, as set out in paragraph 5 of the TMU.

4/ To take effect from program approval date.

5/ The limit is a continuous target (ceiling) on the contracting of concessional debt for the fiscal year by the government or the NBE.

6/ Includes Government of Ethiopia and International Development Association (IDA) contributions to cash transfers and in-kind benefits to beneficiaries under the rural Productive Safety Net Programme (PSNP) and Urban Productive Safety Net Programme (UPSNP).

7/ Outstanding as at end-June 2019.

8/ Numbers updated since IMF Country Report No. 20/29 due to revisions and reclassifications.

9/ The authorities are reconciling the dates of approval for some of the loans by the House of Peoples' Representatives.

Table 2. The Federal Democratic Republic of Ethiopia: Structural Benchmarks

Measures	Target Date	Rationale	Status
December 2019--April 2021			
1. The Public Enterprises Holding and Administration Agency (PEHAA) to publish a consolidated financial performance report, including financial performance of the 20 SOEs under its supervision, using latest available audited accounts starting with 2017/18 accounts.	end-Feb 2020	Sustainability of public sector financing	Not Met
2. Submit a supplementary budget to the House of People's Representatives incorporating the program targets on primary net financing, tax revenues, and PSNP expenditure.	end-March 2020	Sustainability of general government financing	Met
3. Adopt a new excise tax regime that (i) replaces the current tobacco excise tax with an ad valorem excise tax of 30 percent on producer/importer declared retail sales price complemented by a specific excise tax of at least 5 ETB per cigarette pack; and (ii) changes the tax base for ad valorem excises from the cost of production to ex-factory price for all goods.	end-March 2020	Tax revenue mobilization	Met
4. Adopt a roadmap to deepen the FX market and guide the move towards a more flexible exchange rate by the end of the program.	end-April 2020	Liberalization of foreign exchange market	Met
5. Submit to Parliament a budget that includes revenue measures of 1 percent of GDP.	end-June 2020	Tax revenue mobilization	Met
6. Eliminate new NBE financing of DBE.	end-June 2020	Strengthen monetary policy implementation	Met
7. Complete and publish an assessment of tax expenditures.	end-June 2020	Tax revenue mobilization	Not Met (Done with delay)
8. Publish audited financial statements for the CBE and DBE up to fiscal year 2018/19.	end-June 2020	Financial sector stability	Not Met (Done with delay)
9. Complete a review of all subsidies on energy products (including fuels – petroleum products, coal and gas – and electricity), quantifying the value of such subsidies in 2018/19 and 2019/20.	end-September 2020	Rationalizing expenditure	Not Met (IMF TA ongoing)
10. Complete an audit, to be undertaken by the Auditor General, to assess the extent of payment arrears by the Federal Government to suppliers, domestic contractors and other entities providing goods or services to the general government.	end-December 2020	Sustainability of public sector financing	Not Met
11. Complete an Asset Quality Review of the Commercial Bank of Ethiopia.	end-April 2021	Financial sector stability	Not met (AQR exercise ongoing)

Appendix I. Letter of Intent

Addis Ababa, May 27, 2021

Madame Kristalina Georgieva
Managing Director
International Monetary Fund
Washington DC

Madame Managing Director,

On December 19, 2019, the IMF's Executive Board approved arrangements under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) for the Federal Democratic Republic of Ethiopia. However, despite strong program implementation, no reviews have been completed due to delays in obtaining financing assurances from creditors to achieve a moderate risk of debt distress rating by the end of the program. The ECF arrangement is set to expire on June 19, 2021 if no review is concluded by that time. We have requested a debt treatment under the G20 Common Framework to obtain the needed financing assurances but continue to await the assurances. We have engaged closely with the Secretariat on technical grounds and have assigned financial and legal advisors to assist us in the process.

The ECF-EFF-supported program got off to a good start. Revenue collection was strong in the first half of 2019/20, monetary growth contained, and prudent public sector borrowing ensured a declining debt-to-GDP ratio. On the structural front, a new excise tax regime was approved and a roadmap for reforms was adopted to deepen the foreign exchange market and support the transition to a market-determined exchange rate. In addition, good progress was made towards preparing financial statements for key state-owned enterprises. Financial market development was also showing encouraging progress, with net issuance of treasury bills exceeding our targets.

The COVID-19 pandemic necessitated adjustments to near-term macroeconomic objectives. The implementation of fiscal measures to address health and social needs, the deferral of tax payments to support affected businesses, and the reduced revenue collection resulted in a moderately wider-than-anticipated fiscal deficit for 2019/20 relative to program approval. The provision of much-needed liquidity to the banking system increased monetary growth beyond programmed levels.

Despite the challenges created by the pandemic, we continue to implement the reforms envisaged under the Homegrown Economic Reform Program and reached understandings on under the ECF-EFF arrangements. While most June 2020 quantitative performance criteria were missed due to our policy response to the pandemic, most December 2020 indicative targets were met. We also

implemented several structural benchmarks despite competing demands from the pandemic and completed others with a delay. In addition to reforms agreed at the time of program approval, we adopted a comprehensive and transparent plan to restore debt service capacity for SOEs accounting for more than 90 percent of total domestic SOE debt, as well as a roadmap outlining a transition to an interest-based monetary policy framework. Meanwhile T-bill issuance is progressing at a rapid pace, and the real exchange rate has depreciated significantly since the start of the program.

Going forward, we will implement reforms to boost the tax-to-GDP ratio in the FY2021/22 budget. Monetary policy will continue to tighten to reduce inflation to single digits. Continued progress on structural reforms will support developing the financial sector, modernizing the monetary policy framework, and addressing foreign exchange shortages. Public sector reforms and a further strengthening of the businesses environment will reduce debt vulnerabilities and encourage private sector-led growth. We also remain committed to improving Ethiopia's external and overall debt distress rating to moderate by the end of the program. To this effect, we have sought debt service relief from creditors using the G20 Common Framework. Last, but not least, we remain strongly committed to transparency and accountability and using effective mechanisms and controls for the management of funds, including in relation to Covid-19 emergency spending.

In view of the automatic expiration of the ECF arrangement on June 19, 2021, we hereby request a delay in the automatic termination of the ECF arrangement through September 19, 2021. The requested extension would provide more time to obtain the needed financing assurances from official bilateral creditors to achieve a moderate risk of debt distress by the end of the program and to reach an understanding with IMF staff on updated policy commitments.

Very truly yours,

/s/

H. E. Mr. Ahmed Shide
Minister of Finance

The Federal Democratic Republic of Ethiopia

/s/

H. E. Dr. Yinager Dessie
Governor, National Bank of Ethiopia

The Federal Democratic Republic of Ethiopia