DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

April 13, 2020
Approval: 4/20/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/102-3

2:30 p.m., November 30, 2018

3. The Federal Democratic Republic of Ethiopia—2018 Article IV Consultation

Documents: SM/18/270 and Supplement 1; and Supplement 2; SM/18/271

Staff: Escolano, AFR; Fletcher, SPR

Length: 1 hour and 12 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	**Alternate Executive Directors**
D. Mahlinza (AE)	
	H. Razafindramanana (AF)
	C. Moreno (AG), Temporary
	M. Kikiolo (AP), Temporary
	P. Fachada (BR)
Z. Jin (CC)	
	A. Del Cid-Bonilla (CE), Temporary
L. Levonian (CO)	
	S. Benk (EC)
H. de Villeroché (FF)	
S. Meyer (GR)	
	M. Roy (IN), Temporary
	F. Spadafora (IT), Temporary
	Y. Saito (JA)
J. Mojarrad (MD)	
	F. Al-Kohlany (MI), Temporary
	V. Rashkovan (NE)
	I. Skrivere (NO), Temporary
	L. Palei (RU)
	F. Rawah (SA), Temporary
	K.Tan (ST)
P. Inderbinen (SZ)	
S. Riach (UK)	
	P. Pollard (US), Temporary

S. Bhatia, Acting Secretary
S. Kalra, Summing Up Officer
J. Acheson, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: M. Hasegawa, N. Raman, D. Robinson, A. Selassie. Fiscal Affairs Department: A. Soler Vera. Finance Department: M. Spinella. Legal Department: I. Luca. Monetary and Capital Markets Department: T. McGregor. Strategy, Policy, and Review Department: C. Garcia Verdu. World Bank Group: J. Chauffour.

Alternate Executive Director: I. Mannathoko (AE), P. Rozan (FF). Senior Advisors to Executive Directors: G. Gasasira-Manzi (AE), W. Nakunyada (AE), T. Sitima-wina (AE). Advisors to Executive Directors: S. David (AP), J. Garang (AE), U. Latu (ST), A. Olhaye (AF), T. Persico (IT), M. Sylvester (CO), J. Stockill (UK).

3. THE FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA—2018 ARTICLE IV CONSULTATION

Mr. Mahlinza and Ms. Gasasira-Manzi submitted the following statement:

Our authorities appreciate the constructive engagement with staff during the recent Article IV consultations. They broadly agree with the staff analysis and policy recommendations.

Ethiopia has maintained strong economic growth, making significant progress in social development over the last decade. The new administration, which assumed power in April 2018, is committed to consolidating the gains already made towards achieving the country's development goals and transformation agenda. In this regard, they have initiated various far-reaching political and economic reforms since April 2018, including opening up political space and restoring regional diplomatic relations with Eritrea and enhancing cooperation with other neighboring countries. These measures, while aimed at ensuring regional peace and stability, are essential to creating conducive conditions for economic prosperity.

On economic reforms, the authorities have initiated a range of measures aimed at promoting private sector development, including gradually opening up some sectors of the economy that were previously dominated by key state-owned enterprises (SOEs). The authorities plan to cautiously implement these reforms to sustainably transform the economic landscape and uplift living standards. In this regard, they remain committed to the objectives under the Growth and Transformation Plan (GTPII) to sustain rapid and inclusive growth within a stable macroeconomic environment.

Recent Economic Developments and Outlook

The Ethiopian economy grew by 7.7 percent in 2017/18 on account of good agricultural harvests, growth in services and transportation sectors as well as manufacturing exports. The growth momentum was, however, moderated by recurrent political and social unrest, weak commodity export prices and foreign exchange shortages. This notwithstanding, growth is expected to accelerate to 8.5 percent in 2018/19 on the back of an improved political environment, higher Foreign Direct Investment (FDI) inflows, investment in infrastructure and rising productivity levels as export-oriented industries gather momentum. Over the medium term, the authorities' ambitious reform agenda and improved regional relations provide a large upside potential.

Monetary policy tightening continued to bring down inflation, estimated at 11.5 percent by October 2018. This remained above the authorities' single digit target. The high inflation was attributed to politically-related disruptions of economic activity, passthrough effects of the October 2017 devaluation and the expansion of public sector credit in 2017/18. On the fiscal side, prudent budget execution and policy restraint led to a fiscal deficit of 3.7 percent of GDP in 2017/18, as spending was reduced owing to poor revenue performance.

The current account deficit narrowed to 6.4 percent of GDP in 2017/18 from 8.1 in 2016/17, supported by an increase in exports and policies that curtailed public sector imports and borrowing. The level of FDI remained strong at US$3.7 billion in 2017/18, though it slightly declined from US$4.2 billion recorded in 2016/17. International reserves stood at US$3.7 billion in September 2018 and foreign exchange shortages persisted.

Fiscal Policy, Debt Management and Public Financial Management

The authorities remain committed to prudent fiscal policy. Accordingly, they intend to maintain a fiscal deficit of 3.0 percent of GDP in 2018/19, lowering it further to 2.5 percent in the following fiscal year. This will be achieved through several measures, including restraining public sector spending and rationalizing government subsidies, while protecting priority social spending.

Going forward, the authorities will undertake several reform measures to improve domestic revenue mobilization. They intend to increase the share of tax revenue to 15 percent of GDP by 2020. Efforts have been intensified to broaden the tax base and simplify the tax system to ensure equity. At the same time, measures are being implemented to improve tax administration and customs reform, with the help of development partners, including the Fund. Assessments are also being undertaken to improve value added and excise tax. In a bid to ensure transparency, the authorities have put in place a new system to review all tax breaks and incentive schemes to ensure their proper implementation, monitoring and evaluation.

In line with the key objectives of the GTP II, priority will be given to pro-poor spending, specifically in education, health, water and sanitation, agriculture and infrastructure development, particularly roads. An expenditure minimization strategy implemented in 2017/18 is expected to enhance savings by government bodies and will continue to be strengthened together with Public Financial Management (PFM) reforms to improve the efficiency and

effectiveness of spending as well as mobilize domestic resources. Within this strategy, the authorities will continue strengthening their rural and urban social safety net programs, aimed at uplifting households out of poverty in the medium term.

To improve debt sustainability, the authorities have committed to contract only highly concessional debt. Concessional financing will also be sought to complete ongoing projects, while ensuring greater prioritization of new public investments and maximizing participation of the private sector in infrastructure financing through public-private partnerships (PPPs). In addition, ongoing negotiations with bilateral creditors to reprofile non-concessional debt is expected to improve the debt situation. In the meantime, export revenues are expected to increase with the completion of the industrial parks and their full-scale operation. The authorities also plan to strengthen debt management policy, including through firmer controls over SOEs' borrowing policy and improvements in their governance and efficiency. The privatization of SOEs, together with increased FDI and remittance flows will also support debt sustainability.

Implementation of the Treasury Single Account (TSA) and the further roll out of IFMIS and results-based budgeting to public institutions and bodies remain a priority. In addition, a public procurement and property proclamation revision has been completed and sent to parliament for approval. Meanwhile, preliminary work has commenced on the implementation of e-government procurement. Going forward, monitoring and evaluation of public bodies to improve the quality of their financial reporting and delivery, including through the implementation of electronic systems and strengthening of institutional capacity, will be prioritized.

Monetary and Financial Sector Policies

The National Bank of Ethiopia (NBE) is committed to taking appropriate policy measures to bring inflation to the single digit target by the end of the fiscal year. In this regard, efforts to strengthen the monetary policy framework are underway, including further development of the government securities market and establishment of market-based indirect monetary policy instruments. In this regard, technical assistance (TA) has been requested from the Fund to strengthen the central bank operations, specifically, the development of a government debt securities market, strengthening monetary statistics, and exchange rate management.

The financial sector remains healthy, characterized by adequately capitalized, liquid and profitable banking institutions. Non-Performing Loans (NPLs) remain low at 2.96 percent, below the regulatory cap of 5 percent; while provisioning has been adequate. Notwithstanding, the ratio of NPLs has continued to increase to 39 percent at the Development Bank of Ethiopia (DBE), above the supervisory target of 15 percent for development finance institutions. This has been attributed to the low productivity in agricultural projects, political unrest in parts of the country and low international competitiveness of textile projects, to which the Bank has exposure. The NBE is undertaking a comprehensive assessment of the Bank, including its financing to ensure viability.

The NBE continued to make progress in deepening financial inclusion. Some of the initiatives, in this regard, include ongoing work to expand the credit reference bureau to cover microfinance institutions and the development of the financial consumer protection framework. Further, the National Financial Education Strategy (NFES), will be launched in December 2018. At the same time, the authorities continue to make progress in strengthening the AML/CFT framework with measures to address identified deficiencies, contained in the FATF action plan, expected to be completed before the next review in December 2018.

Structural Reforms

The structural reform agenda continues to gain momentum, with the strengthening of existing policy and administrative measures to boost exports, generate jobs, improve competitiveness and support inclusive growth remaining a priority. In this regard, efforts are being made to fully operationalize industrial parks and complete key infrastructure projects. Other initiatives include, agricultural modernization and enhancing the contribution of the services sector, with a special focus on ICT and tourism sectors.

The authorities recognize the importance of private sector participation in the development process. To this end, they have announced an intention to privatize some of the key SOEs, particularly within the telecom, transport and logistics, and energy sectors. In this regard, a governance structure to guide the privatization process has been put in place and regulatory reforms in these sectors have begun. In addition, efforts to improve the ease of doing business, skilled manpower development and increased access to finance are being stepped up, with a view to support small and medium-sized enterprises (SMEs). Further, the authorities plan to develop financial and capital markets.

Ethiopia continues to actively engage in initiatives to reinforce its investment promotion efforts, including the G20 Compact for Africa. In addition, they have signed the African continental Free Trade Area Agreement, as part of an effort to enhance regional value chains and FDI flows. They have also eased visa requirements to foster closer cooperation and regional integration. Further, the improved relations with Eritrea are expected to open new opportunities, including alternative ports to facilitate a reduction in cost, time and efficiency of trade logistics. Complemented by the privatization of logistics services and related policy reforms, export competitiveness and FDI inflows are expected to significantly improve.

In the context of reform implementation, the authorities acknowledge the need for strong institutions, improved governance, transparency and accountability to underpin the reform process. As such, the Prime Minister has taken a number of reform measures including, appointment of a leaner cabinet with 20 Ministries, down from 28; streamlined government agencies to improve their governance and efficiency while clarifying and publishing their mandates and deliverables for the next two years; and committed to reform the judiciary. In addition, a strong stance has been taken against corruption and illicit flows. Commitment to equal representation of women at leadership levels has been demonstrated and gender parity achieved in the cabinet where 50 percent of the Ministers are women. Key decision-making positions have also been taken up by women, including the Presidency and the head of the Supreme Court. In this context, the authorities welcome the analysis in the Selected Issues Paper (SIP) on Women and the Economy in Ethiopia and agree on the need to address the challenges affecting women's economic participation.

With support from development partners including the Fund, the authorities have made progress in data compilation, dissemination as well as improvements to the quality of national accounts. They remain committed to further strengthening statistics with a view to improve their capacity to monitor economic performance. In this regard, they have also requested technical assistance in various areas including monetary policy statistics and have already started planning, together with the Fund, the upgrade to Enhanced General Data Dissemination System (e-GDDS), expected to be completed in the first quarter of 2019.

Conclusion

Having taken appropriate measures to respond to recent political and economic challenges, as noted in the staff report, the authorities reiterate their

commitment to taking additional measures to sustain the economic gains made so far. Combined with strong policy implementation, these reforms should improve competitiveness, reduce external imbalances and rebuild buffers, while raising the growth potential of the economy in the medium term. Against this background, our authorities continue to value their engagement with the Fund and look forward to Executive Directors' support in completion of the Article IV consultation.

Mr. Fachada and Mr. Fuentes submitted the following statement:

We thank staff for the reports and Mr. Mahlinza and Ms. Gasasira-Manzi for their comprehensive statement. The Ethiopian economy has remained robust and growth is expected to accelerate in 2018/19, as the country continues to reduce poverty and making strides towards lower middle-income status. We commend the authorities for their committed implementation of the second Growth and Transformation Plan (GTP II) and their drive to step up private sector participation to expedite the transition from an agricultural-based economy towards a regional industrial and services hub.

Improving revenue mobilization is key for fiscal sustainability. Despite rapid growth in recent years, Ethiopia still lags Sub-Saharan African peers in tax collection relative to GDP. We praise the authorities for their commitment to maintain prudent budget execution and expenditure control. However, their proposed fiscal consolidation plan will require measures to revert persistent revenue underperformance via tax policy and administration reforms. We see merit in the implementation of a comprehensive Tax Transformation Program and support the participation of Ethiopia in the Medium-Term Revenue Strategy (MTRS) initiative.

Comprehensive policy measures are warranted to address external vulnerabilities. The current account deficit has narrowed consistently since 2014/15 and is expected to decline further into the medium term. Nonetheless, deteriorating terms of trade, dwindling foreign reserves and real exchange rate appreciation have weakened the external position and reduced export competitiveness. In this regard, greater exchange rate flexibility could help elevate external competitiveness, address overvaluation, and facilitate the buildup of reserves.

Ethiopia remains at high risk of debt distress. The combination of stagnant export performance, rising debt service payments, and the expiration of grace periods on non-concessional debt are increasing the risks associated

with Ethiopia's debt profile. The Debt Sustainability Analysis (DSA) reveals that public and publicly-guaranteed external debt breaches two thresholds. We welcome the controls on state-owned enterprises introduced by the Ministry of Finance and Economic Cooperation (MoFEC) which has tempered debt distress somewhat. The authorities should continue to press forward in strengthening debt sustainability by improving debt management, and continuing to control non-concessional borrowing and SOE activities.

The monetary authorities could consider transition to inflation targeting. The National Bank of Ethiopia (NBE) has maintained a reserve money targeting framework to control inflation with mixed results. As staff acknowledges, the effectiveness of reserve money tends to decline as the financial system becomes deeper and more integrated. The NBE's intention to develop market-based indirect monetary instruments is a step in the right direction. In parallel, the NBE could consider preparing for inflation targeting, which has led to significant improvements in terms of inflation control and output volatility in some low-income countries.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

Ethiopia's public sector-led development model has contributed to high growth and a reduction in poverty over the last decade. But this model has also stretched public finances, putting the country at high risk of debt distress, and exacerbated external imbalances. In this context, we strongly welcome the authorities' announced structural reform agenda to boost private sector investment, competition, and competitiveness. We agree with staff that this approach – when combined with continued fiscal and monetary tightening, as well as greater exchange rate flexibility – will help address imbalances and put Ethiopia on a more sustainable growth path. We urge the authorities to make a concerted effort to follow through on their ambitious plans to deliver desired results for investors and the public. We broadly agree with staff's well-written analysis and offer a few comments for emphasis.

Planned fiscal consolidation and further reduction in SOE borrowing are critical to reduce debt vulnerabilities and improve the external position. In this context, quick implementation of the PPP framework and planned efforts to improve tax administration are essential to continue needed public investment and social spending. The authorities have already taken welcome steps to improve debt management, such as better prioritizing public investments and strictly controlling public borrowing. We especially welcome the transparent and comprehensive nature of debt statistics, as highlighted in the DSA, as well as MOFEC's commitment to refrain from financing new

projects with non-concessional debt in 2018/19. The DSA indicates that Ethiopia is seeking the reprofiling of non-concessional debt. Could staff please provide an update on these discussions?

The NBE's current tighter monetary policy stance is warranted to bring down inflation. Restrained public-sector credit policies, including a full phase out of NBE budget financing, are needed to complement this stance. Further, we agree with staff's call for greater exchange rate flexibility to support export growth by boosting competitiveness, reduce FX shortages, and rebuild reserves. On the External Sector Assessment, we agree with staff's overall view that the exchange rate is overvalued, which supports their call for greater flexibility, but have questions on the underlying analysis. First, could staff provide further justification on why they included the Penn effect model, especially since the EBA-lite CA model already accounts for this effect? Second, could staff provide further rationale on the 0.5 percentage points adjustment to the current account norm to account for public investment related imports – is this standard practice? We strongly urge the authorities to remove exchange restrictions and accept its obligations under Article VIII.

The authorities' plans to pursue SOE privatizations and open key sectors to competition and private investment present significant upside growth potential if fully executed alongside a strong macroeconomic policy framework. Additionally, foreign investment in SOEs, as well as broader acceptance of foreign investment in the relevant sectors, will bring needed investment, expertise, and healthy competition to help sustain long-term private sector development. What is the expected timeframe for developing the detailed plans for SOE reforms, including privatization, and are there sectors for which the authorities specifically plan to maintain full control of relevant SOEs?

Expansion of access to affordable credit is needed to permit the shift to more private sector-driven growth in Ethiopia. We welcome the authorities' initial commitment to assessments of, and developing reform plans for, the Commercial and Development Banks of Ethiopia (DBE), as well as the commitment to create a government securities market. Together, these actions should improve the health of the financial sector and alleviate the need for NBE financing of the government. In that vein, we support staff's recommendation to discontinue NBE funding to the DBE, particularly when the NPL ratio is at 39 percent, and further urge the authorities to reform the requirement for private banks to purchase NBE bills. In addition, we urge the authorities to more proactively consider preparing a comprehensive financial sector development strategy. The proposed set of reforms provide critical

building blocks, but more is needed to develop a healthy financial system that can support increased mobilization of domestic private investment.

Finally, we support staff's comprehensive capacity development engagement strategy, as outlined in Annex IV. We urge staff to continue to coordinate closely with other TA providers to ensure efficient utilization and sequencing of engagements.

Mr. Benk and Mr. Stradal submitted the following statement:

We thank staff for their informative reports and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful statement.

Despite the recent moderate slowdown, Ethiopia maintained an impressive economic growth over the past decade and a half, while the contributions of industry and services have steadily increased. We welcome the progress achieved in reducing poverty and improving living standards. We fully agree with staff that the public sector-led growth has reached its limits. It would be helpful if staff could provide some data documenting the role of state in different industries. Privatization of the state-owned enterprises (SOEs) and banks, as well as deregulation and opening up of the economy are essential components of a policy mix aiming at accelerating further development. We welcome the new administration's initial steps in this direction and encourage bolder structural reforms to unlock the growth potential. We are concerned in this regard by the medium to high likelihood of domestic opposition to reforms or a policy choice to postpone these reforms for political reasons, as assessed in the risk matrix.

We welcome the authorities' intention to pursue fiscal consolidation. We take note of the remaining high risk of external debt distress and concur with staff that a more ambitious medium-term deficit target is warranted. Consolidating the SOEs into a comprehensive budget framework is necessary for effective management of the budget risks. It should be complemented by strong budget limits and improved governance of the SOEs. The revenue side will have to be enhanced by intensified tax administration reforms and broadening tax base aimed at addressing the very low tax efficiency and stagnating tax-to-GDP ratio.

Monetary policy remains loose despite recent tightening as the real interest rates are negative. A comprehensive overhaul of the monetary policy framework is needed aimed at deepening the flexibility of the exchange rate, enhancing the role of the interest rates in setting the financial conditions, and

firmly anchoring the inflation expectations to an explicit and credible target. The planned development of interbank markets is a key prerequisite and should be complemented by abolishing the requirement for the commercial bank to buy long duration central bank bills. The foreign reserves are inadequate and their gradual increase, coupled with a gradual depreciation of the birr, are needed to build buffers against external shocks and improve external competitiveness.

Staff states that commercial banks appear to be mostly well-capitalized and liquid. However, the state-owned Commercial Bank of Ethiopia, which controls more than half of the banking sector assets and is exposed to SOEs, has yet to conduct an asset quality review, while another state-owned bank exposed to SOEs - Development Bank of Ethiopia – reported an NPL ratio of 39 percent. Is staff in a position to assess the reliability of the reported aggregate banking sector asset quality data? We regret that the authorities indicate no plans to open up the financial sector at this stage. We view it as an essential part of the reform strategy as the inefficiencies in the credit allocation and payments services are a significant dampener on economic activity.

Finally, we welcome the progress in implementing the National Action Plan to address weaknesses in the AML/CFT framework with the aim to be removed from the FATF list of countries with strategic deficiencies. We call on the authorities to accelerate their efforts to this end.

Mr. Meyer and Ms. Fritsch submitted the following statement:

We thank staff for an interesting set of reports, including the work on Women and the Economy in Ethiopia, and Mr. Mahlinza and Ms. Gasasira-Manzi for their insightful buff statement. We largely concur with the thrust of staff's appraisal.

We welcome the authorities' ambitious reform agenda which has the potential to sustain the country's strong economic growth over the medium-term. At the same time, Ethiopia is facing significant downside risks, particularly related to existing debt vulnerabilities as indicated by the DSA which still assesses the country to be at high risk of debt distress. Prudent policies are key to safeguarding the progress achieved over the past years in reducing poverty and improving living standards, but new reform initiatives, as envisaged by the authorities, are necessary to move to a private sector-led growth model.

We see a pressing need for further fiscal consolidation, while protecting poverty-targeted expenditure. Given that the accumulation of debt has been primarily driven by the investment activity of SOEs, we agree with staff that further reining in SOE borrowing and improving governance are important policy priorities. This would increase much-needed public savings and reduce external imbalances. The authorities' firm commitment to refrain from non-concessional financing in the 2018/19 budget and to move ongoing projects to concessional financing is welcome. However, given that concessional financing can also aggravate debt vulnerabilities, we would highlight the importance of paying attention to the efficiency and return of investments and prioritizing projects accordingly. The deteriorating asset quality in the state-owned development bank DBE calls for reform of the DBE with a view to reducing the substantial level of NPLs. We strongly encourage the authorities to follow up on staff's advice and discontinue DBE funding through the National Bank of Ethiopia (NBE). We would also look forward to further information on how the authorities intend to strengthen the DBE's financial performance and reduce the high level of NPLs.

Public sector retrenchment needs to be combined with reforms to crowd in private resources via privatizations and private-public partnerships (PPPs) with adequate safeguards to boost growth and investment, aided inter alia by Ethiopia's participation in the G20 Compact with Africa. However, for the Compact with Africa to unfold its full potential and yield tangible results it is indispensable for the international community to coordinate and step up its efforts. In this vein, we would like to appeal to our partners in the G20 for increased engagement which would be very much appreciated on all sides.

A comprehensive reform of the tax system could help to mobilize additional revenues and reduce public debt levels. Given Ethiopia's mixed performance in mobilizing domestic revenue, we welcome the tax reforms considered by the authorities, including in excises and the rationalization of tax expenditures. In para. 38, staff refers to rationalization of tax exemptions. Tax exemptions are not mentioned in the remainder of the report. What kind of tax exemptions are in place? Could staff quantify the effect of their rationalization on tax revenues?

We share staff's view that a tighter monetary policy is needed, complemented by a more flexible exchange rate to correct external imbalances and restore competitiveness. We welcome the request for Fund Technical Assistance regarding the creation of a government debt securities market as a precondition for the development of market-based indirect monetary instruments. We also underline staff's advice to phase out NBE financing of

the budget. Furthermore, we agree with staff on the presence of significant external vulnerabilities that will require a more flexible exchange rate to improve competitiveness and facilitate the rebuilding of currently thin international reserves. We encourage the authorities to remove exchange restrictions and to move toward eventual acceptance of obligations under Article VIII.

We take positive note of the authorities' ambitious structural reform agenda to open key economic sectors to domestic and foreign private investment and competitiveness. Both the privatization program and the reforms to improve the business environment, especially when implemented steadfastly, could be supportive of Ethiopia's economic development by stimulating growth and exports. We encourage the authorities to communicate the envisaged details and timeline of these reforms early on, also as an important signal to private stakeholders. We also commend the Ethiopian authorities on their efforts to improve the economic and political inclusion of women. As noted by staff, the integration of women into the labor force as well as the elimination of gender pay gaps can result in significant improvements in long-term growth prospects.

Finally, we agree with staff that further efforts to address data gaps and delays is important to improve policymaking and support investors' confidence.

Mr. Virolainen and Ms. Skrivere submitted the following statement:

We thank staff for the interesting report and Mr. Mahlinza and Ms. Gasasira-Manzi for their detailed buff statement. We broadly share staff's analysis and policy recommendations and offer the following points for emphasis on the authorities' opening-up reform agenda, fiscal policy, data and statistics, and the role of women in the economy.

We strongly emphasize the need to promote economic diversification and increase the role of the private sector in Ethiopia. We welcome the new administration's efforts to ensure regional peace and stability, which are necessary pre-conditions for sustainable economic development. We appreciate the authorities' ambitious reform agenda to open up the economy. A successful implementation of the reforms can provide a large positive boost to the economy over the medium term, and we encourage the authorities to not lose the momentum, particularly regarding privatization and PPP reforms. We also share staff's recommendations on improved communication and

transparency regarding the reform agenda to strengthen ownership and understanding by the society.

Strong commitment to a prudent fiscal policy is of key importance to reduce debt vulnerabilities. As Ethiopia still lags behind its peers in terms of domestic revenue mobilization, we welcome the authorities' comprehensive Tax Transformation Program. We welcome the continued improvement of government expenditure efficiency and effectiveness, while at the same time strengthening the social safety net programs and protecting the most vulnerable groups in the society. We agree with staff that efforts to improve SOEs' corporate governance, disclosure, and transparency should be expedited. Technical assistance provided by the Fund can help the Ethiopian authorities with their reform agenda on multiple fronts. However, we note with concern the risk of capacity constraints affecting the impact of TA delivery. It is important to ensure a high-degree of coordination among different TA-recipients, as well as among TA-provider agencies.

We underscore the importance of timely and accurate economic data and statistics. We appreciate the Fund's technical assistance in helping to improve the quality of economic data and statistics. We encourage the Ethiopian authorities to provide the TA experts access to all relevant information, including primary data and methodological tools used in the compilation of the data. In this way, the authorities would be able to gain the maximum value-added from the Fund's knowledge and experience.

We welcome the Selected Issues Paper on the role of women in the Ethiopian economy. The analysis clearly shows that narrowing gender gaps in education and formal employment could lead to substantial economic gains. Social and cultural factors are often cited as one of the reasons behind the underrepresentation of women in certain fields. In this regard, we welcome the new government's political commitment to advance gender equality, as reflected by the appointment of a gender-balanced cabinet and the first female president in Ethiopian history. We appreciate staff's detailed description of the challenges women are facing in Ethiopia in terms of education opportunities, social attitudes, and beliefs, as well as on institutional capacity to integrate gender issues in government policies. However, we found the policy recommendations to be rather general and limited in detail. We would therefore welcome staff's comments on ways to operationalize change in these areas.

Mr. Beblawi and Mr. Al-Kohlany submitted the following statement:

We thank staff for their report and Mr. Mahlinza and Ms. Gasasira-Manzi for the helpful buff statement. The Ethiopian economy made impressive progress in the last decade, resulting in decline in the poverty level and inequality, while improving living standards and the social safety net. The key policy priority for Ethiopia now is to transition away form a state-led economic growth model, where the drivers of growth are large state investments in infrastructure, to a private sector-led economy, underpinned by export-oriented manufacturing and services. We are encouraged by the government's commitment to its Second Growth and Transformation Plan which includes measures to foster private sector participation in the economy. We agree with the staff appraisal and limit our comments to the following points.

Fiscal consolidation efforts should continue to reduce fiscal imbalances and put public debt on a more sustainable path. Noting Ethiopia's high risk of debt distress, we welcome the authorities' commitment to refrain from non-concessional borrowing for new projects, and to shift ongoing projects to concessional financing, when possible. We take note of recent measures taken by the authorities to strengthen debt management framework, including the introduction of firmer controls over SOEs borrowing. On the revenues side, revenue administration reform is a priority given the low tax-to-GDP ratio, as shown in Box 1. Steady progress on the recently adopted public financial management reform strategy is equally important.

The current restrictive monetary stance is appropriate, given the higher than targeted inflation. We note the central bank's continued commitment to bring inflation further down to single-digit. Reining in central bank deficit financing and better control of broad money growth are important measures. We concur with staff on the need to improve the effectiveness of monetary policy transmission with the use of indirect monetary policy instruments. The creation of a government debt securities market would help in that regard. These policies can be complemented by a more flexible exchange rate policy to improve reserve coverage, reduce foreign exchange shortages, and support external competitiveness.

On the financial sector, we note staff's assessment that banks are mostly well-capitalized and liquid and welcome the authorities' attention to enhancing financial sector stability, as evident in the ongoing Commercial Bank of Ethiopia's asset quality review. Non-performing loans (NPLs) remain below the statutory 5-percent ceiling. However, the Development Bank of

Ethiopia (DBE) is a notable exception, with high NPL ratio that warrants close attention. Could staff provide further information on the drivers for DBE's high NPLs levels, and what would be the planned remedial measures?

Structural reforms to enhance business environment, boost competitiveness, and promote privatization are essential to attract productive investments, diversify the economy, and lift growth potential. We welcome the authorities' recently announced reform agenda and encourage them to translate it into prioritized and sequenced reforms plans, with a focus on reducing the SOE footprint in the economy and improving Ethiopia's business climate. The WTO accession process can provide a useful platform to accelerate reform implementation.

Mr. Alkhareif and Mr. Rawah submitted the following statement:

We thank staff for the set of well-written reports and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement. We broadly share staff conclusions and policy recommendations and would like to make the following points for emphasis.

Despite the recent moderation in growth, we take positive note of the high growth levels over a decade and the important progress in poverty reduction and improving living standards. Going forward, prudent policy actions and economic reforms need to be sustained to address fiscal and external imbalances, alleviate debt burden, support private sector-led growth, and further enhance social development. In this context, we welcome the measures taken by the authorities to promote private sector development, including the gradual opening of some sectors of the economy that were previously dominated by SOEs. We also support the authorities' plans to improve the business environment as part of the proposed WB DPF-supported policies. In addition, we agree with staff that privatizations and PPPs, where adequate safeguards are in place and the removal of obstacles to domestic and foreign investment, could help in stimulating growth.

As per the DSA, Ethiopia is at a high risk of debt distress and therefore we see a strong case for pursuing fiscal consolidation. Here, we welcome the authorities' efforts to reduce the fiscal deficit under the revised Medium-Term Federal Fiscal Framework, supported by enhancing tax administration and further expenditure discipline. Also, the authorities' plan to limit future borrowing to concessional financing is a step in the right direction and we encourage further prioritization of public projects.

Finally, we support staff's call for further improving economic statistics and data dissemination. Indeed, this would help support better policymaking and further boost investor confidence. In this connection, we take note of the authorities' TA request on DSA related-issues and on improving monetary and financial statistics.

With these remarks, we wish the authorities further success.

Mr. Gokarn and Mrs. Roy submitted the following statement:

We thank the staff for an informative set of papers and Mr. Mahlinza and Ms. Gasasira-Manzi for their insightful buff statement. Ethiopia has achieved strong economic growth, significant progress in social development over the last decade and witnessed political and economic reforms in 2018, including opening up of political space, restoring regional diplomatic relations with Eritrea and enhancing cooperation with other neighboring countries. However, downside risks such as possible capital flow reversal, tighter international financing conditions, adverse terms-of-trade shocks, weak external demand, failure to reprofile non-concessional debt to increase its concessionality and climate shocks dominate in the short term.

The external sector poses considerable problems for the Ethiopian economy. Import coverage of international reserves is low despite funds flow. Foreign exchange shortages persist, as evidenced by the spread between the official and parallel market exchange rates and the long wait times for businesses to obtain foreign exchange. Would the spread between the official and parallel market exchange rates constitute a multiple currency practice and how could it be remedied?

Several steps have been taken to reduce borrowing. Part of the government deficit was financed through privatization rather than borrowing, Spending was reduced while protecting priority and poverty-reducing programs. Consequently, the net borrowing requirement of the non-financial public sector in 2017-18 declined, including external borrowing. This declined substantially to 3.3 percent of GDP from 13.7 percent of GDP in 2014-15 owing to stricter controls on SOEs' operations to contain external imbalances and as no new projects are to be financed with non-concessional debt in 2018-19. However, despite these measures, the DSA shows that Ethiopia remains at high risk of debt distress, owing to its small export base; and debt service payments are expected to increase in the coming years. Why did these measures fail to make a dent in the sustainability of debt and how can this problem be tackled?

Ethiopia still administers interest rates. Given this, there is little flexibility in the rates depending on free operation of demand and supply of funds. Recently, real interest rates have risen, though they mostly remain negative. One consequence of negative real rates is that they are a disincentive to savers, which keeps gross domestic saving at a much lower level than gross domestic investment, making the country much more reliant on external sources of funds and vulnerable to any pull back of foreign capital. Are there any plans of switching from administered interest rates to freely determined ones in Ethiopia?

Large credit flows to the public sector have led to credit to the private sector remaining subdued, reflecting crowding out. This preference for investment in government securities over commercial lending to private sector also explains the low level of NPLs in the Ethiopian commercial banks. Credit growth has mainly been driven by an expansion of net credit to the central government; inflation remains elevated due to the expansion of public sector credit. While more restrictive monetary base targets and public sector credit policies, including tighter NBE deficit financing, will help bring down inflation, efforts also need to be made to encourage credit disbursal to private sector, if the ultimate goal of increasing private participation in the economy is to bear fruit. Issuing budget-financing securities to banks may allow the gradual phasing out of NBE financing of the government but this will not stop the pre-empting of funds by the public sector. What steps could be taken to encourage banks to finance private sector economic activities and reduce the bank financing of public sector?

The staff report mentions that as part of the structural reforms, and consistent with the authorities' strategy, public sector retrenchment needs to be combined with reforms to crowd in private resources: privatizations, private-public partnerships (PPPs) with adequate safeguards, private concessions, removal of obstacles to domestic and foreign private investment—including in finance—and appropriate market regulation. Of these, adequate and appropriate market regulation to avoid misuse of resources by private sector entities is crucial for a smooth roll-out of privatization without any loss of credibility. Have any steps been taken by the authorities in regard to instituting appropriate market regulations?

We wish the Ethiopian authorities all success in their future endeavors.

Mr. Saito, Mr. Ozaki and Mr. Komura submitted the following statement:

We thank staff for the comprehensive report and Mr. Mahlinza and Ms. Gasasira-Manzi for the informative statement. Ethiopia's economic growth has been strong over the decades with significantly reducing poverty. However, we agree with staff that a public sector-led growth strategy, including investments in large infrastructure by SOEs, is reaching its limits. Specifically, the Debt Sustainability Analysis (DSA) shows that Ethiopia remains at high risk of debt distress. In addition, its external position has been vulnerable with thin international reserves. Therefore, in the near-term, tighter economic policies, together with greater exchange rate flexibility, are warranted to ensure macroeconomic stability. Also, steadily promoting the private sector is imperative to achieve strong and sustainable growth. We therefore broadly support the strategy of the new administration, which includes fiscal consolidation and opening up of the economy.

Fiscal Policy

The DSA shows that Ethiopia remains at high risk of debt distress owing to its small export base. Regrettably, the authorities breached non-concessional borrowing (NCB) ceilings set by IDA for FY 2017 and FY 2018. Debt service payments are expected to increase in the coming years, as grace periods on non-concessional debt acquired in the past expire. Therefore, the use of non-concessional loans should be carefully controlled in order not to deteriorate external debt vulnerabilities. While it is encouraging that the coverage of the data in the DSA looks comprehensive, could staff comment on its quality? In addition, the authorities consider that the DSA overstates public debt vulnerabilities as it reflects the small export base. Could staff comment on their argument?

Sound macroeconomic environment is a critical factor for boosting foreign and private sector investment. Therefore, the authorities should continue fiscal consolidation while preserving resources for their priorities. Given the external position and public debt vulnerabilities, fiscal consolidation including SOEs, while protecting priority spending, like pro-poor spending, is essential for Ethiopia. In this regard, it is encouraging that the authorities have committed to promote fiscal consolidation effort, including domestic revenue mobilization and expenditure prioritization, and to control the contracting of new debt. We welcome that the MOFEC has announced that no new projects will be financed with non-concessional debt in 2018/19. In this vein, we would like to hear staff's assessment on whether the current fiscal framework, including the PPP legal framework, well

promotes clear expenditure prioritization. In addition, we take note that the authorities are seeking the reprofiling of non-concessional debt to increase its concessionality. Could staff elaborate more on this initiative?

Monetary Policy and Financial Sector Policy

Tighter monetary policy, along with greater exchange rate flexibility, would help to address external imbalances and foreign exchange shortages while containing inflation. In this regard, we note that the growth rates of reserve money and those of broader credit and monetary aggregates have diverged. While the National Bank of Ethiopia (NBE) sets reserve money growth rate at 13.3 percent in 2018/19, could staff comment on the optimal growth rate to adequately contain inflation, taking the week transmission into consideration? Beyond the near-term, strengthening monetary policy framework, especially developing a market-based indirect monetary policy instrument, is necessary. We commend the authorities' effort by fully utilizing Fund technical assistance on this front.

The NBE should not continue financing the Development Bank of Ethiopia (DBE). The NBE has outstanding credits to the DBE, 2.4 percent of GDP, whose assets continue to deteriorate, posing quasi-fiscal risk. We also note that the recent 5-year NBE bills needs to be purchased by private commercial banks and then 75 percent of these funds are used to finance the DBE. While it is welcoming that the NBE is conducting a comprehensive assessment of the DBE, could staff expect that the NBE itself can make an effective assessment?

Structural Reform

We support the authorities' ambitious reform agenda, including the privatization of some SOEs. A key to promote economic growth is to foster private sector development and investment while ensuring sound macroeconomic environment. We welcome that the authorities are now developing the detailed implementation plans of their announced reform agenda. While the privatization of some SOEs is an important step, we also encourage the authorities to comprehensively review and thereby conduct necessary reforms on remaining SOEs. In this regard, in order to improve SOEs governance, what should the authorities do other than preparing up-to-date audited IFRS-compliant financial statements of them? Staff's comments are welcome.

Mr. Fanizza, Mr. Spadafora and Mr. Persico submitted the following statement:

We thank staff for an informative report and Mr. Mahlinza and Ms. Gasasira-Manzi for their quite useful buff statement. Ethiopia's economic growth is set to accelerate on the back of dissipating political uncertainty and an ambitious reform drive, championed by the new Prime Minister. A number of bottlenecks must be overcome to further broaden the private sector-led economy and secure sustained growth in the longer-term, which require substantial investments.

External financing constraints and foreign-exchange shortages have hampered private sector activity. We agree with staff that these issues need to be timely addressed. While in the short-term downside risks prevail, economic performance has been remarkable and the recent momentum in economic reforms augurs well. We agree with staff that there are substantial upside risks to the baseline arising from the authorities' concrete reform efforts, some of theme supported by the Development Policy Financing operations recently undertaken by the World Bank. These efforts are paving the way for a sustained export-led growth that could well exceed current projections over the medium term.

Planned fiscal consolidation, based on revenue mobilization, should keep public finances sustainable while reducing vulnerabilities. Tax-policy and administration reforms to bring tax collection back to normal – following last year's decline – are key to deliver on the envisaged front-loaded deficit reduction while maintaining a rigorous management of debt. In this regard, the authorities should take advantage of the Fund's assistance to promptly implement the envisaged Tax Transformation Program.

We welcome the authorities' commitment to reinforcing controls on SOEs borrowing while safeguarding the promotion of export-oriented and growth-friendly investment. We support the staff's call for a rationalization of SOEs' operations, a strengthening of their governance and the removal of existing implicit subsidies. Along with an expansion of the PPP's pipeline, these measures support the transition to a private sector-led economic growth.

Against this background, we share the authorities' view that the DSA is overstating risks and that there is a strong case for the use of judgment to override its mechanical results. In our view, the breaches of the export-based thresholds should be complemented by both the positive export outlook and the envisaged fiscal consolidation. In the context of a comprehensive

statistical coverage, we believe that including in the DSA the Ethiopian Telecom (ETC) debt is questionable. In this regard, could staff provide details on its impact on the overall assessment? We are also wondering on the rationale for lowering the debt-service-to-export threshold (from 20 percent to 15 percent), given that with the previous level the breach would have been very limited. Staff comments are welcome.

Poverty reduction efforts should be complemented by appropriate interventions focused on gender equality and resilience building. We welcome the authorities' commitment to preserving the current social expenditures level while protecting the poorest from fiscal side effects. We would see merits in promoting dedicated instruments to mitigate climate-related risks. As our chair pointed out in the past, addressing labor market inefficiencies, promoting women economic participation, and tackling child labor are all essential to promote inclusive growth. In this regard, we appreciate the Selected Issues paper on gender gap and share its main policy conclusions.

Ms. Levonian, Ms. McKiernan and Mr. Sylvester submitted the following statement:

We thank staff for their useful report and Selected Issues Paper and Mr. Mahlinza and Ms. Gasasira-Manzi for their insightful buff statement. We commend the Ethiopian authorities for the progress made in reducing poverty and maintaining stronger and inclusive growth but note that these achievements have occurred alongside increasing vulnerabilities. Furthermore, with downside risks looming large, the policy discussions were rightfully focused on correcting existing imbalances and further stimulating private sector development to boost growth potential and job creation. As we broadly concur with staff's appraisal and recommendations, we offer the following additional comments for emphasis.

We welcome the strong commitment by the authorities to pursue structural reforms within the context of their Growth and Transformation Plan. These reforms are aimed at, inter alia, boosting private sector growth, diversifying exports, addressing governance and corruption issues, and promoting gender equality. We welcome the helpful Selected Issues Paper on Women and the Economy in Ethiopia, the findings of which suggest that eliminating gender gaps in both educational attainment and the rate of formal employment could increase output over time by over 24 percent. We urge the authorities to harness this and other opportunities as soon as possible. Additionally, we urge the authorities to take steps to further strengthen statistics, including those that foster greater debt transparency.

The authorities' planned efforts on fiscal consolidation and reducing debt vulnerabilities more broadly are welcome, given the assessment of high risk of debt distress. We welcome the authorities' commitment to strengthen domestic revenue mobilization, increase the efficiency of spending, and borrow only on highly concessional terms, while also encouraging the authorities to ensure the more vulnerable in society are protected. Efforts to reform state-owned enterprises (SOEs) and to rely more heavily on private sector participation in the economy, including through public private partnerships (PPPs), will be critical to improve the debt position and to more broadly support growth momentum. With respect to PPPs, we urge appropriate safeguards and reporting of associated contingent liabilities.

We support the authorities' efforts to reduce inflation and address external imbalances. We note that while the authorities broadly concur with staff 's assessment on the external position, it appears that there are contrasting views on the appropriate exchange rate policy going forward. We would be interested in hearing more from staff regarding the analysis of alternative exchange rate paths for the authorities over different time periods. Further, we support reforms to increase the effectiveness of monetary policy and deepen the financial sector, including steps to create a government debt securities market and to address weaknesses in the AML/CFT framework to, inter alia, help mitigate the risk of CBR withdrawals.

Mr. Raghani, Mr. Razafindramanana and Mr. Olhaye submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement.

Ethiopia has maintained strong growth and made further inroads in poverty reduction amid a challenging domestic and external environment in recent years. Growth is projected to accelerate in 2018/19, as the political landscape improves, foreign direct investment (FDI) is expected to pick up and activity in export-driven industries to gain momentum.

The ambitious reform agenda of the authorities provide solid reasons for optimism going forward. The authorities' commitment to the objectives set under their Growth and Transformation Plan (GTPII) towards sustainable and inclusive growth is welcome. We also see merits in their bold reforms aimed at enhancing governance, strengthening institutions, divesting government from key state-owned enterprises (SOEs), and advancing regional integration. Furthermore, we encourage the authorities to pursue greater female

participation in the economy given the potential economic gains—as analyzed in the Selected Issues paper—building on efforts made at the highest levels of government.

While implementing their reform program, the authorities should continue to address the deep roots of the external imbalances and high inflation, notably through prudent macroeconomic policies. In the same vein, we welcome the catalytic drive for reforms to restore peace and stability, including the opening of institutional space at the political level, the signing of a peace agreement with a neighboring country, and the intention to open key sectors of the Ethiopian economy to domestic and foreign private investments. They should also monitor debt developments and take appropriate action to improve debt dynamics. In particular, we are reassured with their indication to renounce to any new projects financed with non-concessional borrowing in 2018/19.

We broadly agree with staff policy recommendations and would like to make specific remarks for emphasis.

Regarding fiscal policy, we encourage the authorities to pursue fiscal consolidation in a growth-friendly manner while protecting social welfare expenditures. We take note of the authorities' commitment to pro-poor spending under GTP II as reflected in Mr. Mahlinza and Ms. Gasasira-Manzi's insightful buff statement. We also welcome the authorities' plan to improve the service delivery under their Productive Safety Net and Urban Productive Safety Net Programs. Meeting the country's social and infrastructure needs will require efforts to boost domestic revenue mobilization and, in this regard, we encourage the authorities to pursue additional revenue-generating tax policies, such as excise reforms; consider the introduction of a property tax; and envisage measures to raise non-tax revenues while improving tax efficiency across the board, as there remains significant room for improvements in these areas. Regarding debt, we encourage the authorities to strengthen their debt management capacity and enhance PPPs, building on the new PPP legal framework. We are further encouraged by the authorities' plan to continue to restructure the country's non-concessional debt. In this regard, can staff comment on the authorities' current efforts to reprofile non-concessional debt with bilateral creditors?

On monetary and financial sector policies, we concur with staff's recommendation that the authorities should maintain a tight monetary policy stance to address financial excesses and reduce inflation. Moreover, we welcome the authorities' aim to create government debt securities market that

will both enable the financing of government debt, while also transmitting interest rate market signals through NBE's interventions. Regarding external competitiveness, we note some divergence of views between staff and the authorities, based on differences in prospects for exports and output growth. Staff's elaboration will be appreciated. On the AML/ CFT framework, we welcome the notable progress in implementing the Action Plan, and encourage the authorities to press ahead in this regard, with the view to attain their objective of removing the country from the FATF's list of countries with strategic deficiencies.

On structural policies, we welcome the authorities' commitment to enhance competitiveness in the private sector and open the participation of foreign and domestic investors in key SOEs. We also welcome efforts to improve SOE governance with up to date audited IFRS-compliant financial statements, as well as the authorities' efforts to cut red tape and streamline regulations, with the view to improve the business environment.

Finally, we call on the Fund to continue supporting Ethiopia through adequate TA in various areas of statistics and policy analysis.

With these remarks, we wish the authorities success in their policy and reform endeavors.

Mr. Inderbinen, Mr. Trabinski and Ms. Urbanowska submitted the following statement:

We thank staff for their insightful set of reports and Mr. Mahlinza and Ms. Gasasira-Manzi for their informative buff statement. Notwithstanding several domestic and external challenges, the Ethiopian economy has performed well over the past decade, allowing for significant progress in reducing poverty and improving living standards. We broadly agree with the thrust of staff's appraisal and we would like to offer the following comments:

Further fiscal consolidation and a strengthening of the public investment process are needed. The policies suggested by staff, including strengthening tax administration and improving SOEs' governance, will allow for growth-friendly consolidation. We encourage the authorities to continue the prudent budget execution and encourage them to further mobilize revenues and increase domestic savings. This would substantially reduce debt vulnerabilities in the long term. We welcome the recent adoption of the five-year public financial management (PFM) strategy, as well as the authorities' commitment to restrain from non-concessional borrowing. Greater prioritization of new projects and increased private sector participation would

be beneficial. Also, a sound privatization program would limit contingent liabilities and have a positive impact on the economy.

Exchange rate flexibility would be critical to reduce the vulnerabilities associated with Ethiopia's external position. The current account deficit has narrowed despite deteriorating terms of trade. However, vulnerabilities arise from Ethiopia's narrow export base and the volatility of export prices. Measures to increase competitiveness and export diversification would help mitigate these risks. Moreover, moving toward a flexible exchange rate regime would be important to reduce the birr's current overvaluation and to rebuild foreign currency reserves.

A tighter monetary policy stance is warranted. We note the central bank's commitment to bring inflation down to the single-digit target. At the same time, we emphasize the need to rapidly terminate the financing of the government. The ambition to deepen financial markets, inter alia by creating a government debt market, is welcome.

Removing gender barriers and increasing economic participation of women would yield substantial economic benefits. We welcome staff's detailed Selected Issues Paper on the potential gains of closing the gender gap in education and raising female employment.

Further progress in addressing AML/CFT weaknesses is needed. We welcome the agreement on an action plan to address the weaknesses identified in the 2017 assessment. Rapid implementation of the action plan will be critical, also in view of maintaining correspondent banking relationships.

Mr. Tan and Ms. Latu submitted the following statement:

We thank staff for the comprehensive set of reports on Ethiopia and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement. We commend the efforts by the authorities to sustain high economic growth over the past decade. Despite the slowdown in 2017/18, we are pleased that growth is expected to persist on a more sustainable level in the coming years. This is supported by staff's recommendation for macroeconomic policy tightening to address external vulnerabilities and other reforms announced by the new government to stimulate private sector activity, which we strongly encourage the authorities to implement effectively. We agree with the main thrust of staff's assessment and would like to add the following comments for emphasis.

Continued prudent fiscal policy design and implementation will support the downward trend of the budget deficit. Measures to improve revenue collection and to rein in import- and debt-intensive public projects through better prioritization are encouraged. This would go a long way in reducing the budget deficit as well as minimizing pressure on Ethiopia's foreign reserves and public debt level, which are already at critical levels. The authorities should prioritize and complete the reform plans as announced to facilitate private sector-led growth, as well as to ease pressure on the central bank (NBE) in financing the government budget deficit which would thereby contribute to enhancing its independence as recommended by the 2009 Safeguards Assessment.

Monetary policy tightening is crucial to curb the consistently high inflation level. We welcome the efforts initiated by the authorities in this regard. We also concur with staff on the need to address exchange rate overvaluation and develop market-determined financial instruments for more effective monetary policy implementation. This would also assist in improving competitiveness and addressing the foreign exchange shortages.

We concur with staff on the need for enhanced supervision of the financial system at both the macro and micro levels. Despite the financial system being well-capitalized and having comfortable liquidity buffers and low non-performing loans (NPLs), the disparities with some of the state-owned banks having potentially high NPLs may pose quasi-fiscal risk. We support the authorities' intention to conduct an asset quality review of the state-owned commercial bank as well as remedial strategies to address the mounting NPLs at the state-owned development bank to minimize threats to financial stability and credit risk to the NBE. To this end, we note that strengthening the financial stability framework is in the capacity development priorities as outlined in Annex IV.

Accelerating efforts to enhance the quality of statistics is highly encouraged. We support staff in recommending urgent steps to be taken. This would not only improve policy decision making but also transparency and support efforts to promote foreign direct investments. Publication of important economic statistics would also assist in educating the public of the government's policies and their effectiveness. We would encourage the authorities to continue to seek the Fund's expertise to support this initiative.

With the above remarks, we wish the authorities of Ethiopia continued success in their reform efforts.

Mr. Villar and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for its comprehensive set of reports, and Mr. Mahlinza and Ms. Gasasira-Manzi for their informative buff statement. Ethiopia's rate of growth has been very dynamic over the past decade and is expected to accelerate further in 2018/2019, helped by the reduction in political uncertainty, higher financial inflows and a more diversified economy. The authorities have been successful in reducing poverty and improving living standards and are making a commendable work in implementing prudent macroeconomic policies while promoting strong structural reforms. However, important challenges persist as Ethiopia's external position remains weak and the risk of debt distress is high; in addition, downside risks continue in the short term, although mostly related to the external environment.

The authorities' plans to pursue fiscal consolidation are commendable. They have committed to further reduce the fiscal deficit and to continue strict control of non-concessional borrowing by SOEs. We welcome the recent adoption of the five-year Public Finance Management reform strategy which aims to improve the efficiency and effectiveness of expenditure. Tax revenue continues to underperform; although the authorities have comprehensive plans to tackle this problem, we see some delay in its execution. Could staff clarify what the main obstacles for a faster implementation are?

The rationalization of SOEs' participation in the economy will help fiscal consolidation besides promoting more private sector development. As part of this process, we see very important a gradual phasing out of subsidies, concurring with staff that this will help to boost public sector savings and give room for more private sector development. To complete the assessment of the financial situation of SOE's and to increase its governance and transparency is of utmost importance; the MOFEC must continue strict control of SOEs' borrowing and to closely monitor their financial performance and plans. We share staffs' view that audited IFRS-based financial accounts are needed for all SOEs, should be produced in a timely manner and published.

To allow private provision of public services through PPP is another key element of the fiscal consolidation plan. Staff mentions that 27 projects have been already screened by the PPP Board, within the context of the PPP legal framework approved in February, of which 13 could be implemented over the next three years. We would like to hear staff's comments on the next steps, in particular if the implementation of these projects will require further approval by Congress.

We share staff's view that authorities must continue with tight fiscal and monetary policies, accompanied by a more flexible exchange rate. We notice in Table 3 that net credit from the NBE to the Government practically equals the base money stock and that most of this financing goes to the DBE whose NPL at 29 percent almost doubles the regulatory ceiling. The obligation of private commercial banks to buy five-year NBE bills in an amount equivalent to 27 percent of gross credit at negative interest rates with this purpose distort market resource allocation. In this regard, we totally agree with staff's recommendation to discontinue funding of the DBE by the NBE at least until the ongoing comprehensive assessment of its financial situation is completed and resolution measures are implemented. We would like to hear from staff if there is a timeline for the completion of this assessment and if there is a resolution framework currently in place in Ethiopia. We would also like to better understand the authorities' point on the need to continue funding the DBE operations; they argue that most of the DBE's customers are current on their obligations; however, DBE's NPLs have reached 39 percent.

We congratulate authorities for their ongoing structural reform program which aims to increase private sector participation and competitiveness including privatization of some SOEs. We also welcome their plans to push reforms to improve the business environment, with support from the World Bank. Ethiopia's recent joining the African Continental FTA is very positive. The authorities' efforts to increase Labor Female Participation are also commendable; we encourage them to continue these efforts to close the gender gap and get the potential economic gains, as shown in the SIP.

We take note of the authorities' position with regard to exchange rate restrictions. Authorities argue the measures taken constitute capital flow management and staff indicates that it is assessing this issue based on the institutional view. Could staff explain when this assessment will be ready and what its implications could be?

We noticed the authorities' request to exclude the debt of Ethiopian Telecom from the DSA, given its profitability and strong balance sheet position; could staff clarify how much the Ethiopian telecom total debt is and how it would affect the results were this be excluded; also, why has this company not presented financial statements in the last three years?

Finally, we are glad to see Ethiopia is taking advantage of a large amount of TA with good results and encourage staff to continue supporting the authorities with their current or future TA requests.

Mr. de Villeroché, Ms. Riach, Mr. Rozan, and Ms. Stockill submitted the following joint statement:

> We thank staff for a comprehensive set of papers and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement. We broadly concur with the conclusions and policy recommendations of the 2018 Article IV Consultation for Ethiopia.
>
> Ethiopia is at an important transition point, with a Government that has signaled strong commitment to reforms aimed at transforming the business environment and increasing the role of the private sector in the economy. It is now important to ensure that a sound regulatory framework is in place to support a successful liberalization of the economy, including phasing out public monopolies and privatization. While growth remains dynamic, the persistence of vulnerabilities (in particular the low level of foreign currency reserves) makes the takeoff of exports, and the materialization of reforms, all the more important. We agree with staff's decision not to incorporate the impact of the authorities' reform plans in their projections, given that PM Abiy Ahmed's reform program is in its early days. However, if delivered, the reform agenda offers significant potential to support a more sustainable growth model and may help mitigate some of the short-term downside risks identified by staff.
>
> Implementing such an ambitious reform agenda will be challenging, and we remain concerned that capacity gaps may hinder progress. We encourage the authorities to make greater use of relevant IMF technical assistance to support their reform agenda (in addition to support from other international organizations), particularly from East Afritac. We believe the Fund can be a vital technical partner for the Ethiopian authorities as they embark on a major set of economic reforms, particularly with regard to foreign currency management, monetary policy and bond market development.
>
> We welcome the authorities' commitment to continuing to pursue fiscal consolidation efforts. This will require continued discipline in capital expenditure and administration, strict adherence to commitments on no new non-concessional borrowing, and significant revenue mobilization efforts. Enhancing transparency and fiscal management will also be key in this regard. Given limited fiscal space, we encourage the authorities to focus on maximizing the returns of existing investments and addressing shortfalls in existing infrastructure (e.g. improving connectivity of existing industrial parks, and ensuring railways are running at greater capacity) before

embarking on large new projects. Given the history of weak domestic revenue mobilization performance, we would also welcome staff reflections on the realism of the revenue mobilization measures (including better tax compliance, tax expenditure rationalization, and introduction of a property tax) suggested in the more ambitious consolidation scenario (deficit target of 2 percent of GDP).

We agree with the conclusions of the new Debt Sustainability Assessment, but would like to seek clarification on some issues. Whilst it is encouraging to see some export growth in the last year, we note that Ethiopia's small export base remains the binding constraint in terms of their risk of external debt distress. We encourage the authorities to redouble their efforts to deliver a sustained export take-off. We welcome the application of tailored stress tests which provide a fuller picture of the vulnerabilities Ethiopia faces from combined contingent liabilities. However, as this is one of the first examples of the implementation of the new LIC DSF, we think the presentation of the assessment could have been clearer. Both in terms of the underlying assumptions used for the baseline scenario and for the stress tests, as well as for the sustainability of the debt (for example, providing a clearer explanation in the risk rating summary of why public debt remains sustainable but the risk of debt distress is high). We would welcome a fuller discussion of the factors that contribute to the assessment of Ethiopia's debt carrying capacity as "medium". And could staff clarify whether the US $1 billion deposit from the Abu Dhabi Fund for Development is considered Non-Concessional Borrowing?

External imbalances remain a concern in Ethiopia, and international reserves are thin. We were disappointed to note that the benefits from the Birr's devaluation in October 2017 have been eroded by a near constant nominal Exchange Rate since. We concur with staff's assessment that the over-valued real exchange rate undermines the authorities' industrialization goals by penalizing exporters and undermining domestic firms seeking to compete with imports. We encourage the authorities to set out a clear exchange rate policy that would be more supportive of the county's export promotion and import substitution objectives. As in previous years, the very low level of foreign exchange reserves remains a concern. Based on previous experience, staff projections of future exports levels may be optimistic. Could staff comment on the potential benefits of an IMF supported program to accompany the transformation of the Ethiopian economy? And given the planned shift in Ethiopia's growth model, could staff elaborate on the potential impact of increased foreign direct investment on the current account and public spending needs?

We note the concerns raised in the staff report about substantial quasi-fiscal risks posed by the Development Bank of Ethiopia's high level of non-performing loans. Could staff provide further detail on the portfolio of the DBE (including its public sector exposure), as well as the risks this poses to the Ethiopian financial system, and the steps that are being taken by the authorities to address these risks?

Mr. Jin and Ms. Ma submitted the following statement:

We thank staff for the well-written set of papers that strike a good balance between making much-needed macroeconomic adjustment and tapping the large upside potential in Ethiopia relative to the baseline projections. We commend the authorities for the ambitious reform agenda such as opening up key economic sectors to foreign and private investment as explained in Mr. Malinza and Ms. Gasasira-Manzi's buff statement. We believe this will help unleash Ethiopia's huge growth and development potentials, mobilize more financing for development, and sustain the strong growth and poverty alleviation momentum. We broadly concur with the thrust of the staff's appraisal and would like to make the following comments for emphasis.

Continued fiscal prudence is warranted to improve debt dynamics and narrow the current account deficit. We welcome the authorities' efforts to reduce public sector borrowing while protecting poverty-targeted spending and its commitment to prudent fiscal policy going forward. As the gradual deficit deterioration is mainly due to revenue underperformance, we encourage the authorities to improve domestic revenue mobilization with assistance from the Fund and other development partners. Taking positive note of the passage of the PPP framework, we believe the successful implementation of PPP projects with sufficient safeguards would raise financing for public goods while minimizing fiscal risks. Firmer controls over SOE's borrowing and progress in improving their governance and financial reporting would help support debt sustainability.

Strong action is needed to reduce inflation and develop monetary policy instruments. Noting the divergence between the growth of reserve money and credit and monetary aggregates, we support the authorities' priority of creating a government debt securities market and establishing indirect market-based monetary policy instruments and welcome the Fund's TA support. We also support staff's proposal to complement these efforts with more exchange rate flexibility. The high NPL ratio of the Development Bank of Ethiopia (DBE) at 39 percent warrants close monitoring, and a

comprehensive assessment of its financial situation is a welcome step in the right direction. Could staff shed more light on the timeline?

We welcome the authorities' privatization program and look forward to more details. The envisaged reform, together with the already-built infrastructure and industrial parks, could attract foreign and domestic private investment together with technology and know-how, and lay a solid foundation for Ethiopia's export take-off. To maximize benefits and control risks, a gradual and well-sequenced approach is more advisable. We also welcome the authorities' efforts to improve the business environment and integrate women into the labor force.

More granular debt sustainability analysis based on the balance sheet approach could better capture the debt conditions. The balance sheet analysis in the 2018 Fall Fiscal Monitor was welcomed by the Board and the wider audience, which can be used to supplement the current fiscal analytical framework. Though we note that the risk of external debt distress is high based on two breaches under the revised LIC-DSF (namely the present value of PPG external debt-to-exports and the external debt service-to-exports), we tend to argue that it is necessary to include the asset side in the analysis. In this regard, Ethiopia has invested heavily in infrastructure and industrial parks, which are productive in nature and expected to generate economic returns in the foreseeable future. Staff's comments are welcome.

Mr. Lopetegui and Ms. Moreno submitted the following statement:

We thank staff for the reports and Mr. Mahlinza and Ms. Gasasira-Manzi for their comprehensive buff statement. Ethiopia has sustained strong economic growth despite facing external vulnerabilities and political tensions with neighbors. Since April 2018 a new government has taken office and reforms are being put forward. The authorities' commitment to implement the Second Growth and Transformation Plan (GTPII) is commendable, as it gives continuation to the important role of government while increasing private sector participation.

We praise the authorities for public finance management and being able to reduce the public deficit. Fiscal consolidation is underway, and we agree with staff it should continue along this path. On the revenue side, efforts are being placed to improve mobilization (which still lags countries in the region and other Low-Income Countries, broaden the tax base, and simplify the tax system. One big challenge will be increasing the efficiency of the domestic tax system. On the expenditure side, the strategy to enhance savings

should be maintained as long as the emphasis on pro-poor spending is not undermined.

Debt sustainability analysis shows that Ethiopia is at high risk of distress, particularly because of external debt. Meanwhile, public and publicly guaranteed debt remains sustainable. We welcome the authorities' prioritization of this issue and the willingness to take concrete actions. It is mentioned in the buff statement that from now on only concessional debt will be issued. Can staff comment on whether this decision is optimal or if other options were considered? The privatization plan and the expected increased FDI and remittance flows should also help towards improving debt sustainability. We just wonder how stable these flows are given that domestic opposition to reforms might affect investors' uncertainty.

Adopting a more flexible exchange rate policy appears to be an important reform to better deal with external risks. We agree with staff that the authorities should be encouraged to remove the restrictions. Could staff comment on why there is such a strong discrepancy with the authorities' view (i.e., whether capital account versus current account payments are being affected). A more flexible exchange rate will help boost competitiveness and reduce FX shortages.

Inflation is above the one-digit goal because of the passthrough effects of the October 2017 devaluation, among other factors. The authorities have not been successful bringing inflation down. In this regard, we agree with Mr. Fachada and Mr. Fuentes that the National Bank of Ethiopia (NBE) could consider preparing for inflation targeting and moving away from reserve money targeting which has rendered mixed results. We take note that the Fund is giving assistance to strengthen central bank operations. Have there been requests from NBE to study the implementation of an inflation-targeting system in the medium term?

We support staff's recommendation to discontinue NBE funding of the Commercial and Development Bank of Ethiopia, as pointed out also by Ms. Pollard and Ms. Svenstrup. Even though the overall financial system appears to be sound, this institution has a high non-performing loan (near 40 percent), and resolution measures might even be considered once its financial situation is assessed.

Competitiveness is still lagging behind and reforms to improve it are welcome. Private partnerships, privatization of state-owned enterprises, as well as improvements in their governance structure, are among the measures

that might bring faster positive results to growth. On the same note, the removal of obstacles for domestic and foreign private investment are welcome measures.

With these comments, we wish The Federal Democratic Republic of Ethiopia and its people success in their future endeavors.

Mr. Mojarrad and Mr. Alavi submitted the following statement:

We thank the staff for a well-written set of papers and Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement.

Underpinned by public investment and productivity gains, Ethiopia has enjoyed high economic growth for over a decade with commendable progress in alleviating poverty and improving living standards. After slowing down in 2017/18 due to political uncertainty, growth in 2018/19 is accelerating as uncertainty abates, and inflation has edged down but remains above the NBE's single-digit target. The fiscal and external current account deficits are narrowing, and public debt, after several years of increase, is expected to decline, although the country remains at high risk of debt distress. International reserve buffers are also thin. Guided by an ambitious Second Growth and Transformation Plan (GTP II), the authorities intend to build on the gains of the past decade and create a conducive environment for a dynamic private sector to sustain high and inclusive growth. This requires a combination of macroeconomic policy tightening and structural reform implementation to narrow imbalances, reduce distortions and inefficiencies, boost productivity and growth potential, and strengthen buffers to enhance resilience to external and climate shocks. Recent opening up of the political space and normalization of relations with neighboring countries, as indicated by Mr. Mahlinza and Ms. Gasasira-Manzi, bode well for the success of the authorities' reform program and improved regional integration. We concur with the thrust of staff appraisal.

Continued fiscal consolidation is key to improving public debt dynamics, reducing external imbalances, and supporting disinflation efforts. We welcome the authorities' commitment to prudent budget execution and encourage a more ambitious deficit reduction target over the medium term. Work should continue to rationalize tax exemptions, reform excises, modernize revenue administration, and strengthen public financial management to create space for poverty-reducing expenditure. Could staff indicate if the authorities are receptive to introducing a property tax? We are pleased to learn from Mr. Mahlinza and Ms. Gasasira-Manzi that the

authorities will further strengthen their rural and urban social safety nets to uplift households out of poverty. Consideration should be given to further prioritizing public projects, strengthening SOE governance, and phasing out implicit subsidies. We note that progress has been made in enacting and rolling out the PPP framework to allow for private provision of public services, and underscore the importance of proper safeguards to mitigate the associated fiscal risks.

Monetary policy, using base money as its operational target, has appropriately aimed at lowering inflation to single digits. Given divergence in the growth rates of reserve money and broader credit and monetary aggregates, however, we agree on the need to complement the base money target with policies to contain credit growth. We also encourage creation of a government debt securities market and developing indirect monetary instruments to better control broad money and credit growth to the public sector and allow gradual elimination of NBE's exposure to the government. A more flexible exchange rate is also needed to better adjust to external shocks, rebuild international reserves, and support external competitiveness.

The banking system is broadly well-capitalized and liquid, with low and well-provisioned NPLs. However, the state-owned Commercial Bank of Ethiopia (CBE) is exposed to risks from SOEs, and asset quality in the state-owned Development Bank of Ethiopia (DBE) continues to deteriorate, with very high NPLs posing substantial quasi-fiscal risks. Could staff indicate when the CBE is to undergo a comprehensive asset quality review, and what remedial actions are being contemplated by the authorities following the financial assessment of the DBE?

Ethiopia's ambitious reform agenda under the GTP II to promote private sector activity is a recognition of the limits to the public sector-led development model. We welcome efforts to improve the business environment, including by cutting red tape and streamlining regulations, and strengthen competition in identified sectors. The unbundling of regulatory, infrastructure operation, and service provision in sectors currently dominated by SOEs should encourage greater private sector participation and pave the way for the intended privatization of a number of key SOEs. At the same time, addressing the large gender gap and improving women's access to education and formal economic activities will increase inclusiveness and reduce poverty. We also welcome the decision to join the African Continental Free Trade Agreement and encourage the government to accelerate progress on WTO accession to improve access to foreign markets and support exports.

We wish the authorities success in their future endeavors.

The Acting Chair (Mr. Zhang) noted that Directors had welcomed the authorities' record of high and inclusive growth and also their recent efforts to ensure regional peace and stability. Directors also noted the challenges to address the issues of external imbalances and public debt burdens. Challenges remained to making the economy more sustainable and inclusive, and in terms of how to make the economy more private sector-led to further strengthen the sustainability of growth.

Mr. Mahlinza made the following statement:

I thank Directors for their many useful comments and policy advice. I also wish to thank the staff for their responses to Directors' technical questions. I just want to take this opportunity to make some additional comments.

The Government of Ethiopia has embarked on a path of political and economic transformation. The political reforms follow a period of social unrest and include opening up political space and discussions with opposition parties on electoral and other political reforms. They also entail restoring regional diplomacy and ensuring both domestic and regional peace and stability, thereby, creating conducive conditions to advance the economic transformation.

Given the magnitude and depth of both the political and economic reforms, the authorities are taking a cautious, structured, and gradual approach, ensuring that the process is well-prioritized, sequenced, and communicated to mitigate the risks of poor implementation while also ensuring broad support and ownership domestically.

The government has also started laying the groundwork to improve transparency and accountability by strengthening and streamlining institutions and reforming the judiciary to allow for regulatory reforms. As such, following announcements to prioritize key state-owned enterprises (SOEs), a governance structure within the responsible government entities was developed to guide the process.

The review of the regulatory framework for some of the priority sectors has already begun. This work is also being supported by the World Bank under their development policy finance operations.

The transformational reform that Ethiopia is currently implementing aims to also leverage the extensive investment that the country has undertaken over the past several years through the privatization process. Policy decisions taken as part of the reform include a restoration of public expenditures, as manifested through the modest budget growth for the year 2018-19; and control of investments in the broader public sector, thereby, maintaining a prudent fiscal stance, further narrowing the current account deficit, and stabilizing the overall debt burden.

A major effort is underway to significantly increase domestic resource mobilization. The enhanced stability of the economy is already reflected in increased participation of the private sector in the economy and is helping boost foreign currency earnings. The authorities have also indicated that the debt rescheduling discussions underway with Ethiopia's major creditors are showing promising results. Against this background, the country is set to see improvements in key macroeconomic indicators of economic growth, fiscal deficit, current account balance, and public debt.

Regarding the Development Bank of Ethiopia (DBE), I note Directors' concerns and would like to assure Directors that my authorities are working to ensure that the risks associated with the bank are mitigated. In this regard, my authorities understand that the current modalities to finance the DBE are not sustainable. They have already reduced the financing to support only a few key ongoing productive projects to avoid a disruption in their activities. In the meantime, a comprehensive assessment is being undertaken and will include measures to ensure its viability as well as explore alternative financing options.

Finally, I want to assure Directors of my authorities' determination to preserve macroeconomic stability and safeguard debt sustainability as they proceed with their transformation agenda. Within the context of these broad reforms and the commitment to preserve macroeconomic stability, the government of Ethiopia has requested support from the international community. In this connection, I look forward to Directors' support.

Mr. Rashkovan made the following statement:

We thank the staff for the well-prepared set of papers and Mr. Mahlinza for the informative buff statement and his initial intervention. We did not issue a gray statement but broadly agree with the staff's assessment and recommendations. With this intervention, we just want to associate ourselves with the statements of other chairs.

Ethiopia's public sector-led growth strategy has resulted in strong economic growth and significantly improved human development indicators; nonetheless, the country faces immediate challenges, with growth slowing down over the medium term and a high risk of debt distress.

We welcome the authorities' tight public sector policies and control of the external borrowings of the SOEs and the set of measures to enhance domestic revenue mobilization. Nonetheless, we agree with Mr. Lopetegui, Mr. de Villeroché, and Mr. Inderbinen, that further fiscal consolidation and strengthening the public investment process are needed.

We strongly encourage the authorities to speed up their tax administration reform while reviewing tax incentives, and to further consider excise tax reform, as well as the introduction of a property tax.

We share Mr. Meyer's view that a tighter monetary stance, complemented by a more flexible exchange rate policy, is needed to consolidate inflationary expectations and to address external imbalances and restore competitiveness.

Like other Directors, welcome the progress in strengthening the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework by addressing the strategic deficiencies listed by the Financial Action Task Force (FATF) in their 2017 regulation report. Further efforts are needed to avoid negative developments in Ethiopia's correspondent banking and the cost of financing.

Just to continue yesterday's valuable discussion on multiple currency practices (MCPs), I saw Mr. Gokarn's question about the potential MCP in Ethiopia and the staff's response. Could the staff elaborate if these cases would be considered an MCP under the new methodology? Were they tested or not?

We agree with Mr. Fanizza that poverty reduction efforts should be accompanied by an increasing focus on gender equality. We welcome their progress in improving women's participation in the labor market and for having gender equality objectives included in their 2030 Sustainable Development Goals (SDGs). Reducing gender disparity would improve labor market efficiency and yield large economic benefits for Ethiopia. We share the selected issues paper's main policy conclusions and encourage the authorities to take further measures on improving women's access to

education, particularly in rural areas, and to increase the rate of female labor force participation in formal sectors.

Finally, the transition to private sector-led growth must be supported by fighting corruption, advancing governance reform, and creating a more level playing field for economic competition. Governance issues in Ethiopia stem primarily from concerns about the implementation of rules and capacity. We welcome the authorities' intention to drastically cut red tape and to streamline regulations as a part of the proposed policies, but we also encourage the staff to more actively personalize the new framework for engagement on governance in practice, including in the next Article IV review for Ethiopia.

Mr. Saito made the following statement:

We thank the staff for the comprehensive report and Mr. Mahlinza and Ms. Gasasira-Manzi for their informative statement and also today's remarks.

It is welcoming that Ethiopia's economic growth has been strong over the decades, with significant declines in poverty and inequality. However, given the current external position and public debt vulnerabilities, Ethiopia is required to move on to a private sector growth model with sound macroeconomic policies. Therefore, we support the strategy of the new administration, especially its structural reform agenda, aiming to boost private sector investment and to encourage competition.

As we have issued a gray statement, we would like to highlight two points. First, on capacity development, while we support the announced reform agenda by the administration, its implementation would be challenging. Therefore, like Mr. de Villeroché and Ms. Riach, we encourage the authorities to fully and systematically utilize the Fund and other donors' technical assistance (TA) to realize the ambitious reform agenda. In this regard, like Ms. Pollard, we commend the staff's comprehensive capacity development strategy in the annex of the staff report, which reconnects the authorities' reform agenda with specific TA.

Second, on fiscal policy and debt management. Given the high risk of debt distress, fiscal consolidation, including among SOEs, is imperative to ensure macroeconomic stability. In this regard, we welcome the authorities' firm commitment to concessional financing and would underscore the importance of improving investment returns and prioritization. On this front,

by corroborating with the other institutions, including the World Bank, we encourage the staff to investigate the efficiency and effectiveness of the investment project in their future discussions with the authorities.

Ms. Roy made the following statement:

We have issued a gray statement but would like to emphasize two points. We had mentioned in our gray statement that credit growth has mainly been driven by an expansion of net credit to the central government, and this could be crowding out the finance for the private sector.

There is another matter of concern which has been pointed out by several Directors, about the high NPL levels in the DBE. The staff has replied that, despite their longstanding advice, no specific timeline has been set for completion of the review of central bank financing and overall functioning of the DBE. In this context, the statement in the staff report that the commercial banks appear to be mostly well-capitalized and liquid, with NPLs well below the statutory 5 percent ceiling, should not make us complacent. That is because, while commercial banks have low NPLs—to a large extent, due to their large holdings of safe National Bank of Ethiopia (NBE) assets—the NPLs in the financial system are substantial on account of the DBE's NPLs of 39 percent, and this is increasing the system-wide risks. Also, although the interest rate on the NBE bills were recently revised, it remains negative in real terms. These bills create several issues.

First, with the bills pre-empting resources from commercial banks and with the on-lending by the DBE leading to large NPLs, there is a wasteful use of scarce lendable resources.

Second, a World Bank study has shown that, as banks were compelled to purchase this bill since 2011, it has slowed down their year-on-year profit growth, from 11 percent to 2 percent. Thus, the directives on compulsory lending and investment could harm the long-term financial health of banks, besides affecting their credit assessment capabilities.

Going ahead, we would encourage the authorities to enable both commercial and development banks to improve their credit assessment capabilities so that they can distinguish between good and bad credit and also to strengthen their governance structure to withstand external pressures for lending. The provision for credit information bureaus and better exchange of information on credit risk between banks and financial institutions would also help these institutions recognize higher risk without incurring excessive costs.

My second point is that the staff report states that real GDP growth in Ethiopia slowed to 7.7 percent in 2017-18 due to political headwinds and shocks, but it is expected to accelerate to 8.5 percent in the next year, as uncertainty abates. While the growth rates appear excellent by themselves, the staff report also states that historical GDP data published by the Fund are those issued by Ethiopia's authorities, and GDP measurement continues to be affected by source data issues, as identified by Fund TA, that are still not resolved. Our question is: How credible are the GDP data for Ethiopia? What can be done to resolve the source data issues? Are there any plans for a follow-up TA to look into these issues again?

Mr. Spadafora made the following statement:

We reiterate our support for the major reform efforts that have been undertaken by the Ethiopian authorities.

Ethiopia is very important for Italy, not least because it is the fourth-largest destination market for our exports in sub-Saharan Africa, but it is even more important for Africa as a whole.

In our gray statement, we expressed some views on the results of the Debt Sustainability Analysis (DSA), and we would like to thank the staff for their answers. However, we share the authorities' view that the DSA may be overstating the risks and that maybe there can be a case for overriding the mechanical results of the DSA. In particular, we believe that one of the most innovative features of the new low-income country (LIC) DSA is the higher importance of a forward-looking component in assessing the sustainability. In the staff report, it is recognized that there is a substantial upside risk to growth to the baseline in Ethiopia because of these major reform efforts which have been undertaken by the government—first and foremost, an effort that targets one of the most important bottlenecks of the country, the small export base. We understand that in assessing the debt-carrying capacity of a country, the new methodology already incorporates some forward-looking elements in the computation of the composite index. We would like to ask the staff whether and to what extent they consider other justifications that could provide the basis for overriding the mechanical results.

Mr. Kikiolo made the following statement:

We thank the staff for comprehensive report and interesting selected issues paper. We also thank Mr. Mahlinza and Ms. Gasasira-Manzi for their informative buff statement.

I will just make two points. First, on fiscal policy, we agree with the staff, that fiscal consolidation would be important to ensure debt sustainability. We welcome the authorities' commitment to prudent fiscal policy; in particular, the recent announcement that new projects would be financed with non-concessional debt going forward. We noted in the staff report that the authorities continue to view the DSA as overstating the risks and consider that there was a strong case for judgment to override the mechanical signal from the framework. We would be grateful if the staff could elaborate on this issue so that we can gain some more insight into the differences of views and the level of traction of the staff's advice.

Second, we wanted to emphasize our appreciation for the selected issues paper on women and the economy in Ethiopia. This is a helpful contribution toward progressing women's economic engagement. The paper clearly demonstrates the macro-criticality of gender issues by quantifying the impact that addressing gender gaps in both educational attainment and the rate of formal employment could have on outcomes in Ethiopia. We encourage the staff to look for opportunities to develop this work further and consider its application more broadly.

We also welcome the authorities' strong commitment to gender issues and the agreement on the need to address the challenges affecting women's participation in Ethiopia. The gender parity in the cabinet is an impressive step in this regard.

Mr. Razafindramanana made the following statement:

We thank the staff for the comprehensive set of reports and Mr. Mahlinza for his informative buff statement and also for his initial remarks. We issued a gray statement. However, we would like to offer a few comments for emphasis.

First, we commend the authorities for sustaining the strong economic growth that is projected to gain momentum. We also take positive note of the authorities' ambitious reform program and commitment to their growth and transformation plan that was praised by several Directors. Moreover, we concur with Mr. de Villeroché, Ms. Riach, and Mr. Saito, that the Fund's TA should be used by the authorities to sustain their reform agenda.

Second, regarding fiscal consolidation, we encourage the authorities to take steps to strengthen the tax administration and enhance the governance of SOEs while preserving proposed spending, as emphasized by many other Directors. Furthermore, within this context, we also welcome the objective of the five-year public financial management reform strategy to strengthen the rural and urban safety net programs, which will be instrumental to lifting households out of poverty.

Third, regarding PPPs, as was raised in Mr. Villar and Ms. Del Cid-Bonilla's gray statements, since the PPP legal framework was enacted, 13 projects have been vetted out of 27, and these vetted projects may be implemented over the next three years. We would appreciate if the staff could provide more details about these projects and their potential economic benefits, particularly as it relates to job creation.

With these remarks, we wish the authorities all success in their endeavors.

Ms. Riach made the following statement:

We thank the staff for the papers prepared for today's meeting and Mr. Mahlinza for the buff statement and his introductory remarks.

We would like to congratulate the Ethiopian authorities on the sustained growth that they have seen. We welcome the government's strong commitment to necessary reforms.

We issued a joint gray statement, so I just have a few points that I want to emphasize. One is that we welcome the staff's application of the new DSA framework and thank them for the additional clarification that they provided in their response to questions.

Second, as a few Directors picked up on, we talked about the issue of TA in our gray statement. While we welcome the Ethiopian authorities' intention to deepen their engagement with the Fund, we believe that implementing the ambitious reform agenda will be challenging, and we remain concerned that capacity gaps may hinder progress. Therefore, we hope that the Fund will be an active technical partner in supporting the authorities to define and implement their economic reform plans.

We are pleased to note the suggested diagnostic assessments in the capacity development strategy. I would like to ask the staff whether they can

say any more about their plans for TA. Is there space to further scale up the planned TA? What are the envisaged modalities for the TA? Are resident specialists being considered?

We would also encourage the authorities to take steps to ensure that TA is as effective as possible, including earmarking sufficient staff for TA objectives and ensuring the requests for TA are well aligned with government reform priorities and Fund surveillance activity.

Mr. Inderbinen made the following statement:

We thank the staff for the good documentation and also the substantive answers to the technical questions for today. We thank Mr. Mahlinza and Ms. Gasasira-Manzi for their helpful buff statement and Mr. Mahlinza for the introductory remarks.

We congratulate the Ethiopian authorities on their economic performance over the past decade, which has allowed significant progress in reducing poverty and improving the living standards of the population. We did not mention this in the gray statement, but we also join those Directors who commend the broader political reforms that have been initiated over the past months, which will ensure the possibilities of regional cooperation, which are beneficial by themselves; but as Mr. Mahlinza noted in his gray statement, would also entail economic benefits.

We welcome the authorities' commitment to further fiscal prudence, and particularly their intent to refrain from nonconcessional borrowing, given the high risk of debt distress. We note in this context the ambition to replace debt-financed infrastructure spending through public-private partnerships (PPPs). While this certainly has a high potential, it is noted as an upside risk in the risk assessment matrix, in that it will provide fiscal space. But there are also downside risks involved in terms of possible contingent liabilities that PPP financing might generate. We welcome the additional explanations that the staff has given in the answers to the technical questions on the safeguards that are put in place, but we do believe this calls for vigilance going forward.

Like Ms. Pollard and Ms. Svenstrup and others, we urge the authorities to terminate the central bank's financing of the government. Here, we found that the staff might have been a bit clearer in the document, and particularly in the appraisal. It is stated that a gradual phasing out of government financing would be good, but we thought a clearer take on this would have been good.

For example, in Table 3 of the monetary survey, one can see a continuous increase in NBE credit to the government that is projected to increase further. We believe a more forceful message would have been in order.

On the related issue of on-lending of the NBE paper via the DBE, we welcome the comprehensive assessment that the authorities will make. We are encouraged by the additional comments that Mr. Mahlinza offered. Like others, we would encourage the authorities to develop a time-bound plan as well. As Ms. Roy and the staff have mentioned, the review is not time-bound now; so a time-bound and specific, concrete action plan would be called for here.

With this, we wish the authorities well in their endeavors.

Mr. Castets made the following statement:

I thank the staff for the quality of the report. I thank Mr. Mahlinza for his helpful buff statement and introductory remarks. We also would like to thank the staff for the detailed answers to our written questions. We have issued a joint gray statement, so I will only emphasize a few points.

First, as already underlined by other Directors, Ethiopia registered strong growth performance over the last few years. The new leadership has announced an impressive new reform program. We understand that it is aiming at transforming the economy toward private sector-led growth, which is welcome. This is the most important development since the last review, and we would like to highlight how much we praise this evolution by the authorities.

Nonetheless, the extent of the challenges ahead should not be underestimated; in particular, implementation bottlenecks, as well as political economy challenges could hamper the reform momentum. As already highlighted by Directors, appropriate TA and support from international organizations would be key to support the authorities' efforts to reform the economy.

Related to that, there are significant vulnerabilities. A constant question for this chair is whether the authorities will manage to rebuild foreign exchange reserves at a sufficient pace to address their needs. There have been some one-off solutions so far, but we wonder whether it could be sustainable. We would appreciate if the staff could elaborate on this issue.

Second, given the current momentum, like Ms. Riach, we see the need for strong engagement of the Fund to support the authorities. We understand that the conditions are not met for a formal Fund-supported program in the country. Nonetheless, TA will be key. I will not repeat the good questions but will just emphasize domestic resource mobilization, on which the track record so far maybe has been relatively weak. I would appreciate if the staff could elaborate on why and where the main obstacles are.

Third, on the new DSA, we thank the staff for the important work done there. It is especially important, given that it is one of the new cases with a new framework. There is probably a learning curve for the Board, as well as the staff. But the coverage is much better and much wider. That was one of the main aims of the new framework, so we appreciate this.

Nonetheless, we have a question. It is more of a question regarding the way we present the new results than a question on the assessment, itself. We feel that the first page lacks clarity. We have this issue of high risk of debt distress but the line below that suggests that debt is sustainable. To be frank, that is not the easiest thing to explain, including to our authorities. Given the time we spend explaining this new framework to our own authorities, we wonder what could be the reading from the external world, which is not as familiar with our framework as we are. We ask the staff to elaborate on this and on their discussion with the authorities on this point because we also feel that maybe the message to the authorities could be a bit blurred.

We have more specific questions regarding the underlying assumptions. We mentioned it in our gray statement. That is probably something that we will have to come back to.

Finally, we would like to support Mr. Rashkovan and other Directors' point on the good selected issues paper on female labor participation.

Mr. Jin made the following statement:

We have issued a comprehensive gray statement, and I would like to make a few remarks regarding the DSA.

We agree with Mr. Mahlinza's opening remarks, that thanks to the systematic investment in trade-enhancing infrastructure and industrial parks, conditions are ripe for an export takeoff in Ethiopia. The authorities' efforts to open up the economy to foreign and private investment and to maintain domestic political stability has paid off. Poverty has been visibly reduced. The

export base has been expanded. Remittances from the Ethiopian diaspora have been on the rise. We have noted that the two breaches under the Public and Publicly Guaranteed (PPG) external debt are related to exports, while the public debt remains sustainable. We believe that the above positive developments could help address the liquidity risks.

As noted in our gray statement, we encourage the staff to supplement the current analysis with a balance sheet approach by incorporating the asset side into the analysis in order to get a whole picture of the public wealth and the net debt situation. This is particularly necessary for countries with large infrastructure development.

To this end, we encourage the staff to start the work from a project level and would also encourage the authorities to improve their fiscal accounting statistics with the Fund's TA, if possible.

The staff representative from the African Department (Mr. Escolano), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for their helpful statements and comments. I would like to touch on three points from the gray statements and the questions that have been raised in the Board.

On the questions that were raised in the gray statements, I would like to make some clarification on the reforms that we have advised and that the authorities are considering regarding the monetary policy mechanism and the exchange rate, and then the reprofiling of debt that some Directors also asked about, and the status of program discussions with respect to the Fund.

On the first point, let me be succinct. Our approach to these reforms of the monetary arrangements, including the exchange rate, is based on three key components.

The first is the reduction and the eventual elimination of central bank financing. That is the explicit objective of the reforms we are suggesting and discussing with the authorities—the elimination of central bank financing of the budget, of the DBE, and other public entities. In our view, monetary and exchange rate policies should focus on low inflation and a competitive exchange rate and the elimination of existing overvaluation or misalignment.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

A second element is the development of a market for short-term government debt in order to strengthen the monetary policy transmission mechanism, which at this point basically consists of one instrument, which is monetary-based, the issuance of monetary-based financing by the central bank, typically, to the government and other public entities. The development of this domestic market of short-term government debt is essential for the development of a market interest rate that could help the central bank to signal its monetary policy stance and affect the cost of funding for the banks and credit in the economy. That is also one of the key conditions for any consideration of an inflation-targeting framework, which is not now being contemplated. But that would require the development of institutional arrangements which are not yet in place. One of the key ones is the development of a market where interest rates are determined by the market and not administratively. If they could go to that market to obtain the financing, this would also serve as a basis for phasing out financing of the government by the central bank.

The third element is the transit to a market-clearing exchange rate system that is backed by appropriate reserves that can sustain this exchange rate. That is a bit of a medium-term objective. It cannot be floated or liberalized completely at once. It needs to be sequenced on a gradual process in which disorderly markets are developed. But the idea is to conduct a more flexible exchange rate policy that aims at correcting the overvaluation of the birr and also the accumulation of reserves that are sufficient to maintain the credibility of the exchange rate system without shortages of foreign exchange, as has been the case, particularly in the last year or two.

In terms of the discussion of the reprofiling of some non-concessional debt, the authorities are seeking to replace existing non-concessional borrowing or debt with more concessional forms of borrowing as part of that general effort, as part of the conditionality of the current Development Policy Financing (DPF) arrangement with the World Bank. The authorities are seeking a reprofiling of an existing loan of about US$2.5 billion with official entities in China, which r has a tenure still of 15 years and a grace period of five years. The authorities are seeking a renegotiation doubling the terms of the loan and the grace period. We understand that the authorities are optimistic about the successful conclusion of these negotiations.

In terms of the status of a possible program with the Fund, the authorities have expressed their intentions to increase their collaboration with international institutions and other development partners, including primarily with the Fund. We have stepped up our engagement with the authorities in

terms of TA, in terms of policy advice, and should the authorities request it, as a financial assistant. However, at this point, the authorities have not made any formal requests for a program. In that sense, there are no current program negotiations. Needless to say, the staff is ready to discuss with the authorities at their request any step-up of these engagements in all these areas.

On the other questions that have been raised in the Board, let me clarify a few of the points.

On the MCP, the staff continues to assess this because we need the data or information that have not yet been received. In part, this is because there has been a significant change in the senior management of the central bank in the last year, and that has resulted in some disruptions in the provision of data and information. We continue to request this information.

However, let me point out that under the new proposed policies on MCPs, the illegal or parallel markets would be excluded from the analysis of spreads for the termination of the MCPs. This was one or the main observations that we have made in Ethiopia, the existence of a parallel market with a significant spread. We can indicate that the authorities would not tolerate this market, if it exists, and the police have raided this market, and there have been actions to repress this illegal trading.

On the DSA, there were several questions. Let me be clear. Two years ago, the staff advised overriding the mechanical signal, and it was jointly decided with the World Bank to do so. However, from one breach on one test last year, there were two breaches of the two tests. The second breach was the breach of the test of debt service-to-exports ratio. That is perhaps different than the original breach, which was watching stock of debt, the net present value of debt, relative to exports. Because Ethiopia has a closed capital account, perhaps because of the existence of a high level of debt—despite the existence of a high level of debt-to-exports ratio—there were some elements that mitigated the risk of a debt crisis or a run on the debt. But the second test indicated that the debt service is too high, relative to exports. That is more difficult to explain away with a closed capital account because that indicates a risk that the authorities or the country may not be able to service its debt punctually.

Last year, the staff and management and the World Bank also agreed to increase their rating to high risk. At this point, we do not see a reason for a reconsideration of this risk. The same arguments apply to the nature of these two breaches of the tests.

We have answered some of the questions on the PPPs directly in the written answers. But let me point out that there has not yet been a single PPP that has been closed and that has started implementation. Thirteen of them are in the last stages, but they have not been implemented nor have they started implementation yet. Therefore, it is difficult to assess these PPPs. I am sure the monitoring and the process of approval will evolve based on experience over time and we will learn from experience. But at this point, most of these PPPs relate to the energy generation sector. They basically are PPPs for the private sector to build and operate stations for the production of energy, of electricity, and then sell power to the grid. This has required significant legal and regulatory changes, and the pricing of electricity in a way that is consistent with private sector participation. This is part of these reforms. We expect this to start taking place in 2019. They have benefits for the economy, which is still in need of higher energy production.

There have been some questions on TA. We would be glad to provide the specific plans for TA. They include a long-term resident adviser, which has been requested by the central bank, to advise the senior management of the central bank and help with the implementation of these reforms that I described. It has not been posted yet, but it will be soon. Then there will be an increase in more direct TA, both from headquarters and from the East Africa Regional Technical Assistance Center (AFRITAC East).

This covers TA on national statistics. As some Directors have noted, the staff has serious concerns or criticisms about the nature of the national account statistics. We have been clear with the authorities on this. To some extent, the reason is just their lack of technical capacity. To some extent, it is in the absence of a sound estimate. There is always a temptation to choose among the range of possible estimates, those that are more convenient or are more politically convenient. We believe that the increase in capacity will help greatly in resolving this issue, and we are providing TA in this area.

Mr. Spadafora noted that when comparing the previous year's breach in the debt service obligation ratio to the breach this year, one had to take into account the fact that there had been a change in the threshold from 20 to 15, which was a major difference. The comparison was not completely justifiable because there had been a change in the methodology.

The staff representative from the African Department (Mr. Escolano) responded that Mr. Spadafora was correct.

Mr. Castets reiterated his previous question on whether the first page of the DSA provided sufficient clarity on the situation facing Ethiopia.

Mr. Meyer made the following statement:

> I did not intend to intervene today, but two points have triggered my intervention.
>
> I support Mr. Castets' point on the first page of the DSA. I will come back to that.
>
> My first point is that we should be careful not to talk every country into asking for a program. I understand the authorities have not asked for a program. In the documents, I could not find anything that suggested a balance of payments need that would make a program necessary at the moment. Of course, there are development needs as well. In that regard, the Fund plays a catalytic role. I agree with what many have said in that regard: Strong surveillance and TA are playing a crucial role in that regard. Not every country has to be run into a financing program. If we are talking about a non-disbursing program to give some more visibility to what the authorities are doing, this has support from our side.
>
> On the DSA, I am not fully capturing yet what we all decided on the new DSA for LICs. I remember that the application of judgment plays a role. But I wanted to note that there is some judgment in the document as well, in showing the relevance of the possible volatility on the exports because of a narrow base; and for that reason, the authorities could quickly run into difficulties. What looks quite acceptable today might be a big problem tomorrow. If one looks at paragraph 19, there was some judgment in that regard. But the staff's comments on what using judgment means in a formal sense could also be helpful on the front page of the DSA.
>
> I cannot stop without commending the authorities for the good progress they have made. It is crucial to move to private sector-led growth. In that regard, the Compact with Africa hopefully can also play a role.
>
> Finally, it seems to be clear that reining in SOEs is important to move to a more sustainable situation.

The staff representative from the Strategy, Policy, and Review Department (Mr. Fletcher), in response to further questions and comments from Executive Directors,

made the following additional statement:

To reply on the question about the Debt Sustainability Framework, we take note of the comments, and we will reflect on those. I would just note that the front page does say clearly that Ethiopia is at high risk of debt distress, so hopefully that message is clear.

On the issue of debt sustainability, that is a different concept that we have, rather than the risk rating. For example, it is a requirement for the Fund to assess that debt is sustainable in order to be able to lend. There are cases where the risk of debt distress is high, which is really a statement not about the baseline but about the risk around the baseline. There are cases in which there is a high risk rating in the DSA based on the risk, but where we nonetheless assess that debt is sustainable. That is something that we have to do in order to be able to lend. We have to be clear that debt is sustainable.

Mr. Castets made the following statement:

We are familiar with the difference between the two notions, our question is really about the presentation, the message that is sent to the authorities.

If one looks at the first page, frankly, it is a bit difficult to understand that the debt is sustainable but is at a high risk of debt distress at the same time.

We know it implies a scenario and also the credibility of the pace of fiscal consolidation that will be applied with regard to historical trends. We have a question around the presentation. Presentation is important in that case, including for all the partners, not just the Fund. We will probably need to reflect a bit further, but it is also for the authorities of the concerned countries to say whether the message of the Fund is clear when reading just this front page.

Mr. Mahlinza made the following concluding statement:

Once again, on behalf of my Ethiopian authorities, I thank Directors for their supportive comments, candid views, and invaluable policy advice. We have taken note of the comments on the DSA, in terms of presentation and also some of the comments around the issue of judgment, which we have highlighted in previous statements. I will immediately convey to the

authorities these comments by Directors for use in guiding the implementation of their macroeconomic policy and development agenda.

I also wish to extend my thanks to management and the staff; in particular, the mission chief, Mr. Escolano, and his team, for the detailed and productive discussions with the authorities during the mission in Addis Ababa. I also want to further express appreciation for the responses to the issues raised by Directors during the discussion.

As acknowledged by many Directors, Ethiopia has achieved strong economic growth and has made significant progress in social development over the last decade. More essential investments in productivity-enhancing reforms and the prudent mix of macroeconomic policies—specifically, the tightening of policies—have ensured continued growth despite several challenges.

My authorities have taken note of the staff's assessment of the macroeconomic imbalances and related vulnerabilities. I would like to assure Directors that they have resolved to take bold reforms and institute appropriate policies to address the challenges and transform the economy. They remain steadfast in their objective to achieve rapid, sustainable, and broad-based growth in a stable macro environment, as envisaged under the comprehensive second five-year growth and transformation plan. In this regard, they plan to, first, maintain prudent fiscal policies, with a focus on poverty reduction programs, as well as strengthen revenue mobilization and growth-enhancing investment projects while maintaining debt sustainability.

Second, they plan to strengthen their monetary policy framework to improve its effectiveness and gradually move toward more flexible policies, with the help of TA from the Fund.

Third, they plan to develop the financial sector and safeguard its stability, while supporting financial inclusion initiatives and greater access to financing for small- and medium-sized enterprises (SMEs) and the private sector.

Fourth, they plan to implement far-reaching structural reforms to create a favorable business environment and promote private sector participation, strengthen institutions, improve human capital, and create jobs, including taking measures to improve the participation of women and youth in the economy, with the aim of supporting strong, inclusive, and sustainable growth.

In conclusion, I would like to assure the Board of my authorities' determination to pursue strong policies to preserve macroeconomic stability and safeguard debt sustainability, while persevering with their structural reform agenda to support sustainable growth and socio-economic transformation.

My authorities appreciate the policy advice and TA provided by the Fund and development partners. They remain committed to engagement with the Fund in line with the pledge made by the prime minister during his courtesy call on the Managing Director at the Fund in August, wherein he committed to strengthen this relationship and seek the Fund's support in the implementation of the authorities' reform agenda.

The Acting Chair (Mr. Zhang) noted that the Federal Democratic Republic of Ethiopia availed itself of the transitional arrangements under Article XIV, but no longer maintained restrictions under that Article. It maintained exchange restrictions subject to Fund approval under Article VIII; however, the authorities did not request Fund approval of these restrictions, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They noted that Ethiopia has maintained high and inclusive growth for more than a decade, achieving commendable progress in reducing poverty and improving living standards. However, the public sector-led development strategy is reaching its limits, exacerbating external imbalances and raising public debt vulnerabilities. Directors commended the authorities for tightening macroeconomic policies to address these challenges. They welcomed the authorities' ambitious reform program aimed at catalyzing private investment and driving sustainable growth as set out in the Growth and Transformation Plan II.

Directors underscored the need for fiscal consolidation and higher revenue, through tax policy and administrative measures, further prioritization of public projects, reductions in the borrowing requirements of state-owned enterprises (SOEs) and phasing out of implicit subsidies. Rationalization of tax exemptions and excise reform would help in this regard. Further improvements in public financial management and SOE governance and transparency are also warranted. Given the risks posed by the high debt burden, Directors called for strengthening public debt sustainability. They noted the efforts at reprofiling of non-concessional debt and welcomed the authorities' intention to contract new debt at concessional terms. Directors

commended the authorities for their plans to protect social and pro-poor spending.

Directors noted that the tighter monetary stance announced by the National Bank of Ethiopia (NBE) for 2018/19 is warranted to bring inflation down to target. This stance should be supported by restrictive public sector credit policies, including gradually phasing out central bank financing of the budget. Exchange rate flexibility would help strengthen competitiveness, reduce foreign exchange shortages and support reserve accumulation. Directors recommended the elimination of the remaining exchange restrictions on current transactions.

Directors noted that financial sector reforms would increase the effectiveness of monetary policy and support development goals. These reforms should include the development of a market for government securities with market-determined interest rates. Until this market develops, NBE bills should be used solely to manage liquidity in the banking system, and delinked from funding of the Development Bank of Ethiopia which needs to complete a comprehensive financial assessment. Directors noted that channeling the payment of taxes through banks could deepen financial intermediation, reduce opportunities for corruption and improve the business climate. Gradual opening of the financial sector to foreign investors could improve services and transfer technology and know-how. Directors also noted that continued efforts are required to strengthen the AML/CFT framework.

Directors stressed that implementation of structural reforms is critical to promoting competitive markets and improving the investment climate to catalyze private investment. Privatizations, public-private partnerships with adequate safeguards, and removal of obstacles to private investment could support renewed growth momentum while attracting foreign resources and know-how. Directors underscored the importance of addressing data gaps and delays to improve the quality of statistics. They welcomed Ethiopia’s decision to join the African Continental Free Trade Agreement and looked forward to progress toward World Trade Organization membership. Directors also welcomed the joint analysis conducted with UN Women which shows that further reducing gender disparities would yield large economic benefits over time and commended the authorities’ efforts in this direction.

It is expected that the next Article IV consultation with The Federal Democratic Republic of Ethiopia will be held on the standard 12-month cycle.

APPROVAL: April 20, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Regarding external competitiveness, we note some divergence of views between staff and the authorities, based on differences in prospects for exports and output growth. Staff's elaboration will be appreciated.***

- Staff continues to expect strong export and output growth in Ethiopia over the coming years, as political uncertainty abates, FDI inflows resume and export-oriented industries take root. However, the track record over the last few years suggests caution in projecting future performance, as growth in export revenue has been disappointing and the international environment remains challenging. Staff forecasts for exports in particular are based on actual performance in the past and projected aggregate indicators, and WEO projections of commodity prices. This typically results in more subdued prospects than by using a bottom-up approach based on planned exports of different industrial zones and companies, often used by the authorities, and which has typically over-projected exports in recent years. Staff does however recognize the significant upside potential related to the ambitious reform agenda announced by the authorities, which if fully implemented, could result in overperformance relative to staff's baseline projection.

2. ***Could staff comment on the potential benefits of an IMF supported program to accompany the transformation of the Ethiopian economy? And given the planned shift in Ethiopia's growth model, could staff elaborate on the potential impact of increased foreign direct investment on the current account and public spending needs?***

- Staff will address orally the first question during the Board meeting.

Second question:

- Increases in FDI are expected to result is significant increases in exports volumes and value, particularly in manufacturing and other new export lines (e.g., horticulture, agro-processing), albeit from a low base. But also the increase export-processing activities will contribute to imports, although to a lesser extent (by the export-processing activities value added). Also there will probably be a higher net transfer abroad of profits and interest payments by the private sector. These effects in the current account are incorporated in staff projections both in the baseline and

reform scenario. To the extent that strategic FDI investors acquire public companies, or replace the public sector in the provision of some goods and services, this will mitigate pressures for higher public investment and expenditure in key sectors. This is a key component of the strategy advocated by staff to palliate the potential negative effect on growth (and living standards) from reductions in public sector expenditure.

Fiscal Policy and Reforms

3. ***In para. 38, staff refers to rationalization of tax exemptions. Tax exemptions are not mentioned in the remainder of the report. What kind of tax exemptions are in place? Could staff quantify the effect of their rationalization on tax revenues?***

- The issue of tax exemptions is long-standing in Ethiopia and has been discussed in previous the 2016 and 2017 staff reports. There is ongoing engagement by FAD and the World Bank with the authorities at both the technical and policy level in this area. FAD is currently providing TA on the assessment of costs in the area of CIT exemptions. It was agreed that the first steps were to take stock of existing exemptions and quantify their costs and benefits—progress has been made on this. However, the ultimate aim of this analysis should be to produce annually a reassessment of tax incentives and a report on these exemptions as part of the budget process. The MOFEC agrees with this approach, but little progress has been made on this—mainly due to low implementation capacity, but possibly also because predictable resistance from line ministries and investment promotion agencies. Staff continue to urge the authorities to accelerate progress in this area, which is critical to improving domestic revenue mobilization, a key policy priority for Ethiopia. Existing tax exemptions are widespread in the areas of CIT, VAT, and customs.

4. ***Tax revenue continues to underperform; although the authorities have comprehensive plans to tackle this problem, we see some delay in its execution. Could staff clarify what the main obstacles for a faster implementation are?***

- Tax revenue collection continues to underperform—falling for 3 consecutive years to 11.2 percent of GDP in 2017/18, and below the average for LICs (see 2017 staff report, Box 2). The authorities are implementing measures to tackle this problem, focusing on tax administration, and are also open to tax policy measures. However, there are multiple obstacles to faster implementation of these plans, including: limited implementation capacity, frequent changes in the leadership of the Ministry of Revenues (formerly ERCA) which has a cabinet position, a weak taxpayer register, obsolete IT systems, large number of tax incentives that hamper administartion, and high staff turnover. FAD is providing assistance through a medium-term TA program on tax administration, while other donors including the World Bank and DfID, are also providing support and resources in this area (including experts to be embedded in

the day-to-day processes of the tax administration). Staff has emphasized the need to consider tax policy measures on excises and other taxes to raise revenue in the short term while longer-term reforms are implemented.

5. ***Given the history of weak domestic revenue mobilization performance, we would also welcome staff reflections on the realism of the revenue mobilization measures (including better tax compliance, tax expenditure rationalization, and introduction of a property tax) suggested in the more ambitious consolidation scenario (deficit target of 2 percent of GDP).***

- The reform scenario includes policies on tax administration and tax policy that aim to significantly increase domestic revenue mobilization, as well as improvements in tax expenditure and budgeting. While the authorities have signaled their willingness to consider these reforms, they have not yet fully committed to many of them. These reforms are assumed to lead to a faster reduction in the deficit over a 5-year horizon, relative to the baseline. The reform scenario envisages a reduction in the fiscal deficit from 3.7 percent of GDP in 2017/18 (which included the use of non-debt-creating privatization receipts) to 1.9 percent of GDP in 2022/23. This would require a fiscal tightening of 1.8 percentage points of GDP which is well within recent experience in Ethiopia other countries in the region if the appropriate measures are implemented.

6. ***[W]e would like to hear staff's assessment on whether the current fiscal framework, including the PPP legal framework, well promotes clear expenditure prioritization.***

7. ***We would like to hear staff's comments on the next steps, in particular if the implementation of these projects [utilizing PPPs] will require further approval by Congress.***

- The PPP framework is new (the PPP law was passed in February 2018) and it is still too early to assess its effectiveness in practice. A new PPP unit has been established in the Ministry of Finance (MOFEC) and 13 PPP projects have already been assessed and approved (although none have actually been fully concluded and implemented yet).

- MOFEC is aware of the risks related to the use of PPPs—indeed this was a key reason for establishing the new PPP unit in MOFEC—and is intent on strictly monitoring the acquisition of liabilities. The authorities have requested further TA in this area, and the Fund is working to mobilize the necessary resources, alongside other donors, including the World Bank (which has hired a firm to advise on PPP guidelines and the tasks of the unit) and DfID.

- No further approval is required by parliament on PPPs in areas where the authorities are soliciting private sector participation though, depending on the nature of the PPP project, there may be sector-specific legal constraints that need to be addressed for specific PPP projects.

8. ***Could staff indicate if the authorities are receptive to introducing a property tax?***

- The authorities have not indicated their intention to introduce a property tax in the near term, but they have expressed their willingness to discuss and consider this policy. Staff will continue to argue for the introduction of this tax as a means to raise revenue as well as to fund the decentralized regional budgets.

Monetary Policy

9. ***Are there any plans of switching from administered interest rates to freely determined ones in Ethiopia?***

10. ***Have there been requests from NBE to study the implementation of an inflation-targeting system in the medium term?***

- Staff will address orally these issues during the Board meeting.

The following is additional information on these areas.

- The authorities have requested technical assistance to modernize the monetary framework but given the level of development of financial markets, this will take time and necessitates a gradual approach. In addition, close coordination between the NBE and the Ministry of Finance will be required, especially as the latter would have to bear the cost of issuing securities that are increasingly issued at market-determined rates as these reforms get underway.

- The NBE has indicated interest in receiving technical assistance on a number of fronts, including modeling to support a forward-looking monetary policy framework. MCM is seeking to place a long-term expert in Addis Ababa to provide advice to NBE senior management. At present, the priority for reform, and hence TA support, is to support operational and institutional reforms that are necessary to transition to a more modern monetary policy framework—including the creation of an interest rate channel and more flexible management of the exchange rate.

11. ***While the National Bank of Ethiopia (NBE) sets reserve money growth rate at 13.3 percent in 2018/19, could staff comment on the optimal growth rate to adequately contain inflation, taking the [weak] transmission into consideration?***

- As noted in the staff report, staff believes the announced stance is appropriate in view of the need to address the elevated inflation. Nevertheless, the NBE should stand ready to adjust its stance in light of economic developments to ensure macroeconomic and financial stability. Over the longer term, it will be important to move away from a reliance on base money and develop indirect instruments to manage liquidity and credit conditions, especially in view of the growing size and sophistication of the Ethiopian financial system.

Exchange Rates/Exchange Restrictions

12. ***First, could staff provide further justification on why they included the Penn effect model, especially since the EBA-lite CA model already accounts for this effect?***

- The Penn effect model is used to supplement the two EBA-Lite models (CA and REER). It is based on the well documented empirical regularity, that the price level (and hence the real exchange rate) is higher in countries with higher per capita incomes and is commonly used in the academic literature (e.g. Rodrik, 2008). The Penn model is different to the EBA-Lite CA model, which estimates the level of the current account that is consistent with medium-term fundamentals and desirable policies, but it has similarities with the EBA-Lite REER model. As noted in Annex II, the results from the Penn effect model are consistent with the EBA-Lite models and has been useful in furthering discussions with the authorities to persuade them to address misalignments in the exchange rate. This approach has also been used in past staff reports and is in line with the ESA guidance which encourages staff to expand their analysis using additional methodologies that are suited to country characteristics.

13. ***Second, could staff provide further rationale on the 0.5 percentage points adjustment to the current account norm to account for public investment related imports – is this standard practice?***

- This partial adjustment to the CA norm is consistent with past practice in the case of Ethiopia and has been implemented in both 2016 and 2017 staff reports. Similar to the approach taken in those reports, staff adjusted the norm for part of the imports arising from public investment spending. This is to account for the enhanced need for investment in Ethiopia given its needs for growth-enhancing basic infrastructure and other basic investment. The adjustment is small (0.5 percent of GDP) and its inclusion does not materially change the results of the assessment.

14. ***Would the spread between the official and parallel market exchange rates constitute a multiple currency practice and how could it be remedied?***

- Despite the continued existence of the parallel foreign exchange market, as evidenced by the spread between the official and parallel market rates, the Ethiopian authorities do not tolerate this market, and actively prosecute those agents who engage in parallel market transactions. The National Bank of Ethiopia, though various directives (e.g., Directive No. FXD/49/2017) and proclamations (e.g., Proclamation No. 591/2008), sets the conditions, limitations and circumstances under which Ethiopians, residents of Ethiopia and non-residents may utilize foreign currency. In particular, these regulations: establish reporting requirements of foreign exchange holdings when entering the country; set time limits for the surrendering of foreign exchange holdings; establish the channels through which foreign exchange should be surrendered (only authorized forex bureaux); and set the penalties in case these regulations are not met, which include punishment under the penal code of Ethiopia and the confiscation of the foreign exchange.

- Staff is currently assessing whether the spread between the parallel market rate and the official rate constitutes a multiple currency practice. To this end, staff has requested data from the authorities on exchange rates in both markets over a period of time in order to determine whether the additional spread in the parallel market represents additional costs and risks of the cash transactions over spot transactions. If an MCP were to be found, it could be remedied if sufficient FX were to be provided by the central bank in the official market for bona fide foreign exchange transactions. A durable solution to the foreign exchange shortages, which are the underlying cause of the spread, could be achieved through a combination of tighter fiscal and monetary policies and greater exchange rate flexibility as detailed in the Staff Report.

15. ***We would be interested in hearing more from staff regarding the analysis of alternative exchange rate paths for the authorities over different time periods.***

- Staff will address orally these issues during the Board meeting.

The following is additional background information on these matters.

- The optimal path for the nominal exchange rate in Ethiopia will depend on (i) the level of misalignment in the exchange rate, and (ii) the degree to which movements in the nominal exchange rate pass through to inflation. Staff advised the authorities that the elimination of the misalignment will require the adoption of a more flexible decision process for setting the nominal exchange rate, without pre-committing to any path of depreciation given the thin reserve coverage, and tight monetary policy to contain inflation. There is ongoing technical assistance from MCM in this area, and which is seeking to provide a long-term expert to advise the senior management of the NBE.

- Staff produced an analysis of the degree of exchange rate pass through into inflation in the Ethiopian economy (2017 AIV staff report; box 3). A vector auto-regression (VAR) relationship was estimated between the nominal effective exchange rate (NEER) and the consumer price index (CPI) using monthly data over the period 2003-2017 and controlling for international oil and food prices. The results suggest that, based on past experience and policy settings in Ethiopia, a 1 percent decrease (depreciation) in the nominal exchange rate is associated with a 0.4 percent increase domestic prices over 18 months. However, under a macroeconomic policy stance tighter than the historical norm, the pass through would be lower.
- The authorities adopted a tight monetary policy and inflation is beginning to come down (11.5 percent in Oct 2018 compared to a high of 15.6 percent in Feb 2018).

16. ***Could staff explain when this assessment [of exchange restrictions] will be ready and what its implications could be?***

- As noted in the staff report and informational annex, staff concluded that Ethiopia maintains four exchange restrictions inconsistent with obligations under Article VIII of the Articles of Agreement at the time of the 2017 Article IV consultation, a finding which the Board endorsed. The authorities however did not agree as they consider the restrictions as being solely aimed at capital and financial account transactions. Staff found that the restrictions identified last year remain in place in 2018 and therefore, do not recommend any change in the assessment. In light of this, the Board's finding of the existence of exchange restrictions inconsistent with Article VIII would stand.

17. ***Could staff comment on why there is such a strong discrepancy with the authorities' view (i.e., whether capital account versus current account payments are being affected).***

- In general, the authorities base their view on the fact that the measures are intended to dissuade what in their view are non-legitimate demands for foreign exchange, thereby allowing the system of rationing foreign exchange to work; and, in one case, a measure that supports tax compliance. Staff's findings are based on not just the stated or intended aim of the measures but also their impact on the effective ability of economic agents to engage in legitimate current account transactions and effect payments related to them.

Financial Sector

18. ***Is staff in a position to assess the reliability of the reported aggregate banking sector asset quality data?***

19. ***Could staff indicate when the CBE is to undergo a comprehensive asset quality review?***

- The authorities do not provide financial accounts or information at the individual bank level. Staff recommended the authorities undertake a Financial Sector Stability Review, which could look into the compilation of financial stability indicators.

- As noted in the staff report, the authorities are planning an asset quality review (AQR) for the state-owned Commercial Bank of Ethiopia (CBE), which accounts for over 60 percent of banking system assets. This is part of the conditionality of the World Bank's DPF and is expected to be completed by end-May 2019, although the NBE has still not issued the required instruction to the CBE to begin the AQR process. The CBE has already committed to undertaking a comprehensive financial audit by an international auditing firm and is currently in the process of selecting a firm.

20. ***Could staff provide further information on the drivers for DBE's high NPLs levels, and what would be the planned remedial measures?***

21. ***Could staff provide further detail on the portfolio of the DBE (including its public sector exposure), as well as the risks this poses to the Ethiopian financial system, and the steps that are being taken by the authorities to address these risks?***

22. ***We would also look forward to further information on how the authorities intend to strengthen the DBE's financial performance and reduce the high level of NPLs.***

23. ***What remedial actions are being contemplated by the authorities following the financial assessment of the DBE?***

24. ***While it is [welcome] that the NBE is conducting a comprehensive assessment of the DBE, could staff expect that the NBE itself can make an effective assessment?***

25. ***We would like to hear from staff if there is a timeline for the completion of this assessment and if there is a resolution framework currently in place in Ethiopia. We would also like to better understand the authorities' point on the need to continue funding the DBE operations; they argue that most of the DBE's customers are current on their obligations; however, DBE's NPLs have reached 39 percent.***

26. ***The high NPL ratio of the Development Bank of Ethiopia (DBE) at 39 percent warrants close monitoring, and a comprehensive assessment of its financial***

situation is a welcome step in the right direction. Could staff shed more light on the timeline?

- Staff has not examined in detail the bank resolution process is in place in Ethiopia—and has advised the authorities to undertake a diagnostic FSSR which would analyze this among other areas. However, as noted in the staff report, the DBE is not a commercial bank but rather, in fact, a government development finance agency—as it does not take deposits. As such, it would not likely to go through a bank resolution process, should it be required.

- The NPLs reflect a number of factors, including problems with legacy loans to the manufacturing and agro-processing sectors from an earlier phase of the industrialization program. Recent economic challenges, including the forex shortages and impact of political unrest, have also contributed to the increase. The DBE's loan portfolio is largely directed to the private sector, though some public companies are among its clients.

- In recent months, the authorities have replaced the senior management of the DBE with a view to strengthen the prudential role of its management team. The focus of the authorities now is to undertake a comprehensive review of the role and status of the DBE, including of its financial position. The review itself could be seen as having two distinct components: a review of the role of the DBE, which needs to be conducted by the authorities, and a close examination of the operations and financial conditions. On the latter, there is merit in engaging independent reviewers to ensure a thorough and impartial review.

- While the planned review is underway, the DBE is expected to continue to operate as the authorities see the DBE as being an important source of long-term project financing. Staff's long-standing advice has been to move more decisively on the NPLs, and for the NBE to halt further financing of the DBE—at least until the assessment is completed and a strategy for the future role of the DBE has been formulated, including a viable financing model that does not rely on central bank financing. No specific timeline for the completion of the review has been set.

27. ***What steps could be taken to encourage banks to finance private sector economic activities and reduce the bank financing of public sector?***

- Private banks in Ethiopia do not provide financing to SOEs and instead are oriented mainly toward the private sector. However, most of these banks are relatively small, accounting in total for less than 40 percent of total banking system assets. SOEs on the other hand raise financing through the issuance of bonds in the domestic market—mainly to non-bank financial institutions—and borrowing from the state-owned

Commercial Bank of Ethiopia, which is the largest commercial bank in Ethiopia. In 2018/19, the authorities plan to more than double the credit provided to the private sector through the redirection of credit through public entities (CBE, DBE) and credit intermediated by private banks.

- In staff's view, the tight monetary stance—which is necessary to bring down inflation and strengthen external competitiveness—needs to be complemented by fiscal restraint, including for SOEs. As a package, these policies would give commercial banks to expand their support of the private sector. In addition, financial development could be catalyzed by reforms aimed at strengthening financial inclusion and development, the channeling of tax payments through banks, and starting the process of opening the financial sector to reputable foreign entrants.

Debt Sustainability Analysis

28. ***The DSA indicates that Ethiopia is seeking the reprofiling of non-concessional debt. Could staff please provide an update on these discussions?***

29. ***In addition, we take note that the authorities are seeking the reprofiling of non-concessional debt to increase its concessionality. Could staff elaborate more on this initiative?***

30. ***Can staff comment on the authorities' current efforts to reprofile non-concessional debt with bilateral creditors?***

- Staff will address these questions during the Board meeting.

31. ***In the context of a comprehensive statistical coverage, we believe that including in the DSA the Ethiopian Telecom (ETC) debt is questionable. In this regard, could staff provide details on its impact on the overall assessment?***

32. ***Could staff clarify how much the Ethiopian telecom total debt is and how it would affect the results were this be excluded; also, why has this company not presented financial statements in the last three years?***

- The total external debt outstanding of Ethio-Telecom amounted to US$1.8 billion at the end of 2017/18 (2.2 percent of GDP). Excluding this debt from the DSA would improve debt dynamics but would not change the DSA's conclusions. The information necessary to make a judgment on whether the debt of Ethio-Telecom meets the criteria for exclusion from the DSA as set out in Appendix III of the LIC-DSF Guidance Note is not yet available. A key obstacle in undertaking this assessment is that recent audited accounts for Ethio-Telecom are not yet available. As

noted in the DSA, staff looks forward to engaging with the authorities when such information becomes available. On the delay in presenting financial statements, this has been a challenge for a number of SOEs, which the authorities are working to address.

33. ***It is mentioned in the buff statement that from now on only concessional debt will be issued. Can staff comment on whether this decision is optimal or if other options were considered?***

- The current debt situation in Ethiopia makes any new borrowing on non-concessional terms unadvisable, and staff has actively argued against this. Further, staff understands that the World Bank has set a zero non-concessional borrowing ceiling as part of the recently-approved DPF. In the medium to long term, strengthening domestic revenue mobilization offers a more durable solution to sourcing financing to meet development needs. FAD, along with the World Bank and other donors, are providing support to the authorities in this area.

34. ***Why did these measures fail to make a dent in the sustainability of debt and how can this problem be tackled?***

- The DSA reflects the build-up in the stock of debt over a number of years, which will take time to deal with. During this period, the authorities will need to maintain strict control over new borrowing and refrain from accumulating non-concessional debt in order to ensure the long-term sustainability of the debt and bring it down to levels that are commensurate with lower risk. In addition, restrictive policies are needed to ensure that that debt service burdens remain manageable and narrow external imbalances.

35. ***While it is encouraging that the coverage of the data in the DSA looks comprehensive, could staff comment on its quality? In addition, the authorities consider that the DSA overstates public debt vulnerabilities as it reflects the small export base. Could staff comment on their argument?***

36. ***In this regard, Ethiopia has invested heavily in infrastructure and industrial parks, which are productive in nature and expected to generate economic returns in the foreseeable future. Staff's comments are welcome.***

- Ethiopia has among the most comprehensive and exhaustive statistics on debt among low-income countries, reflecting the high priority placed on debt recording and management by the authorities.

- Staff agrees that Ethiopia's small export base exacerbates risks. This reflects the fact that exports are an important source of foreign exchange necessary to keep its external debt sustainable. Over time, the export base will expand, but given its current size, this will take time even with rapid growth, as in staff's baseline projections. This growth reflects the large investment in trade-enhancing infrastructure that has been put in place over the last few years, which has provided the base for a take-off in exports.

37. ***We are also wondering on the rationale for lowering the debt service-to-export threshold (from 20 percent to 15 percent), given that with the previous level the breach would have been very limited. Staff comments are welcome.***

- As noted in the DSA, the lowering of the threshold reflects the new DSF, itself the outcome of analytical work undertaken by staff in the context of the Review of the Debt Sustainability for Low-Income Countries, which was approved by the Board in November 2017.

38. ***We would welcome a fuller discussion of the factors that contribute to the assessment of Ethiopia's debt carrying capacity as "medium". And could staff clarify whether the US $1 billion deposit from the Abu Dhabi Fund for Development is considered Non-Concessional Borrowing?***

- The assessment debt-carrying capacity in the new LIC-DSF is based on the new composite index (CI). The CI—which includes the Country Policy Institution Assessment (CPIA) score compiled by the World Bank, global and domestic economic growth, remittances, and the level of international reserves—updates the old methodology, which was solely based on the CPIA score. Ethiopia, with a CI value of 2.72, is currently classified as having a medium-debt carrying capacity. Ethiopia's high real GDP growth relative to other countries provides a positive contribution to its CI, whereas its low and declining reserve coverage relative to other countries results in a comparatively lower index. It should also be noted that Ethiopia's debt carrying capacity under the old methodology was also judged as "medium", reflecting the continued importance of the CPIA in arriving at this assessment.

- The deposit placed by the ADFD does not meet the threshold to be classified as a concessional loan (35-percent grant element on present-value basis) used by the Fund and the World Bank to guide their operations.

Structural Reforms

39. ***It would be helpful if staff could provide some data documenting the role of state in different industries.***

- Data shortcomings due to the lack of financial data of key public enterprises prevent staff from providing a precise estimate of the role of state in economic activities. In a number of areas such as telecommunications, no private sector participation—even by Ethiopians—has been possible. Indeed, in these sectors, the state-owned enterprise also acts as the regulator, an arrangement that will need to be unbundled as it is being done in electricity generation and transmission. This also accounts for the need for a sequenced reform program to ensure the reforms to the legal framework and appropriate regulatory infrastructure are in place before the sectors are opened up to the private sector.

40. ***What is the expected timeframe for developing the detailed plans for SOE reforms, including privatization, and are there sectors for which the authorities specifically plan to maintain full control of relevant SOEs?***

- While no specific timeframe has been adopted, the authorities indicated that work would proceed by sector, with logistics, energy, transportation, and telecommunications expected to move forward first. On plans for privatization, the authorities have only noted that they will maintain majority stakes in what they term strategic companies in the energy, transport, logistics and telecommunications sector. They are open to the full privatization of SOEs in all other sectors.

41. ***In this regard, in order to improve SOEs governance, what should the authorities do other than preparing up-to-date audited IFRS-compliant financial statements of them? Staff's comments are welcome.***

- The authorities are committed to the improvement of SOE governance, which is one of the specific aims of the privatization program. They have already put all SOEs, including those in priority sectors, under the supervision of the Ministry of Public Enterprises (MoPE) with the aim of improving SOE governance and restructuring where necessary. Staff argued for granting the MOFEC vetting powers on the financial management and financial plans of SOEs.

42. ***Have any steps been taken by the authorities in regard to instituting appropriate market regulations?***

- The authorities have already put in place regulation for the logistics sector, which has been open to domestic and foreign private competition, and they are in the process of unbundling the regulatory functions in telecoms, railways, and electricity generation. The World Bank's recently agreed DPF operation is supporting the authorities in this

area. However, it is important that the process of privatization not be rushed and the appropriate market structures and regulations are put in place to foster growth-enhancing competition and prevent the emergence of monopoly rents.

43. ***We appreciate staff's detailed description of the challenges women are facing in Ethiopia in terms of education opportunities, social attitudes, and beliefs, as well as on institutional capacity to integrate gender issues in government policies. However, we found the policy recommendations to be rather general and limited in detail. We would therefore welcome staff's comments on ways to operationalize change in these areas.***

- The policy recommendations in this area are based on analysis carried out jointly by IMF Staff and UN Women and summarized in a Selected Issues Paper (SIP). The purpose of this analysis was to (i) assess the challenges affecting women's economic participation in Ethiopia, (ii) quantity the potential macroeconomic benefits of increasing female labor force participation, and (iii) raise awareness of the issues with the Authorities, other policy makers, and stakeholders. The Ethiopian authorities welcomed the analysis and agree on the need to address the challenges affecting women's economic participation. Policy steps in the area of women's economic participation are the subject of a process of national dialogue, where the authorities are exerting leadership—supported by UN Women and other donor. In this connection, staff is aware of guidance not to duplicate efforts with other institutions. Given Ethiopia's stage of development, continued progress on human development (health, education, etc.) is the priority for increasing women's economic participation. Possible areas of future work in connection with Fund's core topics of competence could include gender budgeting.