ETHIOPIA
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ETHIOPIA

- **The strong growth of Ethiopia's economy in 2014/15, estimated at 10.2%, is expected to continue in 2016 and 2017, while public investment is expected to ease infrastructure bottlenecks and bolster economic structural transformation.**
- **Ethiopia faced severe drought in 2015 requiring emergency food and aid in 2016 and causing inflationary pressure, while the risk of public-debt distress increased due to rising non-concessional borrowing and export underperformance in 2014/15.**
- **The urban population, growing at 3.8% per annum, is expected to reach 42.3 million by 2037, which could pose significant development challenges if not addressed.**

Overview

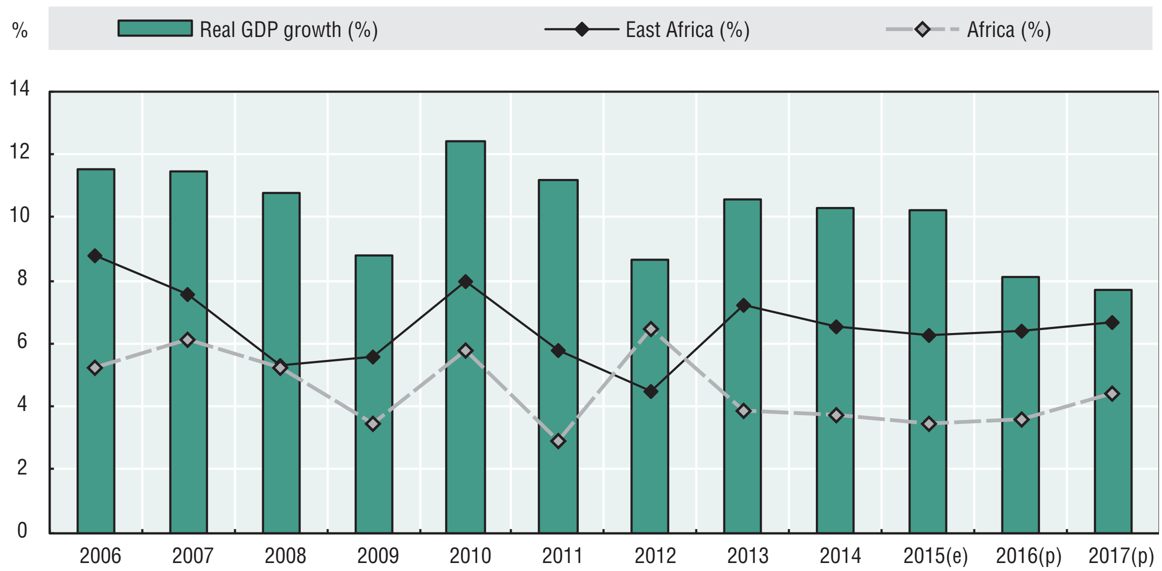
Ethiopia has experienced double-digit economic growth, averaging 10.8% since 2005, which has mainly been underpinned by public-sector-led development. Real gross domestic product (GDP) is estimated to have grown by 10.2% in fiscal year 2014/15. The agriculture, services and industry sectors accounted for 38.8%, 46.6% and 15.2% of real GDP, respectively. Public investments are expected to continue driving growth in the short and medium term with huge investments in infrastructure and the development of industrial parks, prioritised to ease bottlenecks to structural transformation, which will still have to take shape with industry playing a significant role in the economy.

Fiscal policy has remained prudent, focused mainly on increasing spending on pro-poor and growth-enhancing sectors, and on boosting efforts in tax-revenue collection. The monetary-policy stance has been geared to ensure a stable exchange rate and single-digit inflation targets. Despite this, inflation has tended to rise from single digits and reached 10.1% in December 2015. Although Ethiopia has been pursuing a sound debt-management policy, debt-burden indicators signalled a rise in debt distress from low to moderate in 2015, as indicated by the World Bank/International Monetary Fund (IMF) debt-sustainability analysis. Moreover, poor performance and volatility in export earnings, and ever-increasing demand for imports have led to a deterioration of the balance of trade deficit.

In 2015, Ethiopia faced one of the worst droughts in 30 years caused by the El Niño climate conditions, leading to failed harvests and shortages of livestock forage. Some 10.2 million persons have been affected by the drought and will need emergency food and non-food aid into 2016.

Ethiopia, the second most populated country in Africa after Nigeria, is also the least urbanised, with urbanisation at only 19%, significantly below the sub-Saharan average of 37%. The urban population has grown at an average 3.8% per annum since 2005 and is expected to triple from 15.2 million in 2012 to 42.3 million by 2037. This could pose a significant development challenge if not addressed. Since 2004/05, the government has focused more on developing housing, upgrading slums, providing infrastructure and promoting small urban enterprises.

Figure 1. **Real GDP growth**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. **Macroeconomic development**

	2013/2014	2014/2015(e)	2015/2016(p)	2016/2017(p)
Real GDP growth	10.3	10.2	8.1	7.7
Real GDP per capita growth	7.7	7.7	5.6	5.2
CPI inflation	8.1	7.7	7.4	8.9
Budget balance % GDP	-2.6	-2.0	-1.3	-0.8
Current account % GDP	-10.9	-14.6	-8.4	-9.3

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent developments and prospects

Ethiopia, having registered high economic growth since 2005 at an average 10.8% per annum, stands out as one of the fastest growing economies in the world. In 2014/15, real GDP grew by 10.2%, keeping the momentum of the 10.3% growth rate of 2013/14. The services sector contributed 4.7 percentage points of this growth followed by industry and agriculture contributing 3 and 2.5 percentage points, respectively. While the share of agriculture in the GDP declined over ten years from 47% in 2004/05 to 39% in 2014/15, that of the services sector increased from 40% to 46% in the same period. Meanwhile, the contribution of the industrial sector remained low, at 15% of GDP in 2014/15. The strong economic growth has been underpinned by the country's public-sector-led development strategy, with its focus on heavy investment in infrastructure.

Despite its declining contribution to GDP over the years, agriculture remains the leading sector in terms of contribution to the country's overall economy. It is a major source of food for domestic consumption, of raw materials for the domestic manufacturing industries and of primary commodities for export. Moreover, the sector contributes 73% of employment, and supplies 70% of the raw-material requirements of local industries. Livestock and livestock products, as well as food crops, were the leading contributors to agriculture-sector growth in 2014/15. Ethiopia's agriculture depends highly on traditional farming methods and a rain-fed farming system, and is vulnerable to environmental and climate-related shocks. In 2015, Ethiopia was severely hit by

El Niño, and agricultural added value is projected to decline in 2015/16. Excessive dependence of agriculture on the vagaries of nature needs to be circumvented through massive investment to modernise the agricultural system. Climate change is also a major threat to the sustainability of growth due to its negative impact on agricultural output, but also to the additional cost of climate-resilient infrastructure.

The service sector grew by an impressive 10.2% in 2014/15, mainly due to improvements in hotels and tourism (29.2%), transport and communications (13.3%), wholesale and retail trade (9.9%) and financial intermediation (6.9%).

The fiscal year's growth in the industrial sector was also significant (21.7%), mainly driven by buoyant performance in the construction subsector. The manufacturing subsector, which accounted for merely 4.1% of GDP in 2014/15, was dominated by food processing, beverages, textiles, hides and skins, and leather industries. Since 2010, a considerable amount of investment has been directed towards establishing cement factories in response to the strong surge in demand for cement emanating from major construction activities in the country. The limited change in the structure of the economy, especially with regard to manufacturing, is partly explained by the low levels of investment and the sluggish growth of the private sector, which was too slow to affect its historically small share of labour-intensive manufacturing.

Huge public infrastructure investments have led to widening the gaps in investment and savings (17.5% of GDP in 2014/15) and in the external sector. These macroeconomic imbalances have in turn led to increases in external borrowing. Consequently, the stock of external public debt has soared fivefold, from USD 2.8 billion in 2008/09 to USD 19 billion in 2014/15. The sharp increase in the stock of public debt has been driven primarily by major import-intensive public-enterprise investments.

Export performance has remained sluggish. The average value of export earnings between 2011/12 and 2014/15 was USD 3.1 billion. In 2014/15, the value of merchandise exports totalled USD 3 billion, posting an 8.5% decline year-on-year. This was due to a fall in the volume of exports (such as coffee and pulses) and decreases in gold, oilseeds and pulses prices. Imports have increased substantially since 2011/12. The annual merchandise-import bill, largely driven by capital goods, increased from USD 11 billion in 2011/12 to USD 16.6 billion in 2014/15, thereby widening the current-account deficit. Poor performance and volatility in export earnings and an ever-increasing demand for imports were the main reasons behind the worsening trade-account deficit. The effect on the overall balance-of-payments deficit, however, was not pronounced (-0.8% of GDP) as surpluses in services and capital account had a mitigating effect. Private transfers, including remittances, also offset the rise in imports. Favourable prospects for export diversification have nonetheless been boosted by an improved environment for foreign direct investments (FDI) in the manufacturing sector and potential electricity exports.

Although inflation was contained to single digits at 8.1% in 2013/14 and 7.7% in 2014/15, it has tended to rise since June 2015 and reached 10.1% in December 2015. Inflation in food prices has been on a continuous upward trend since the beginning of 2015, while non-food inflation largely followed a stable trend. In 2015, Ethiopia also faced one of the worst droughts in 30 years caused by El Niño climate conditions. Absence of rain in February/March 2015 and delays in the onset of the main rains in June/July in some parts of the country led to crop failure and shortages of livestock forage. Some 10.2 million people have been affected by the drought and need emergency food and non-food aid into 2016, while the full impact on the economy has yet to be assessed. This has caused inflationary pressures in the economy.

The outlook remains positive as economic growth is projected to remain strong in the coming two years. Sustained investments in agriculture and mobilisation of resources by galvanising the people through community participation are expected to drive further economic growth. However, two key downside risks remain. First, Ethiopia's agriculture remains vulnerable to adverse weather fluctuations and environmental calamities. Second, weaknesses in the global economy and the decline in commodity prices, particularly for coffee, gold, oilseeds and pulses, will affect export earnings negatively. Sustained investments in the agriculture sector, including in areas such as irrigation, and ongoing efforts to diversify and grow the export base will mitigate these downside risks.

Table 2. **GDP by sector (percentage of GDP at current prices)**

	2009/2010	2014/2015
Agriculture, forestry, fishing and hunting	46.8	38.8
of which fishing	0.1	0.1
Mining and quarrying	0.7	0.8
of which oil	…	…
Manufacturing	3.9	4.8
Electricity, gas and water	1.2	1.0
Construction	4.5	8.5
Wholesale and retail trade; Repair of vehicles household goods; Restaurants and hotels	18.8	21.7
of which hotels and restaurants	4.1	5.3
Transport, storage and communication	4.5	4.8
Finance, real estate and business services	11.9	9.7
Public administration and defence	3.4	5.0
Other services	5.1	5.3
Gross domestic product at basic prices / factor cost	**100.0**	**100.0**

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

The Government of Ethiopia has been pursuing a prudent fiscal-policy stance to maintain stable macroeconomic conditions and generate an environment conducive to sustaining the country's high economic growth. In 2014/15, fiscal policy remained cautious and mainly focused on increasing budgetary spending on pro-poor and growth-enhancing sectors, and on increasing tax-revenue collection. Tax collection increased from Ethiopia Birr (ETB) 133.1 billion in 2013/14 to ETB 165.3 billion in 2014/15, and general government expenditure increased from ETB 185.5 billion to ETB 224.9 billion in the same period. Capital spending remained at 9.7% of GDP (down by 0.8 percentage points from 2013/14) while the GDP share of recurrent spending increased from 7.4 in 2013/14 to 8.5% in 2014/15. Pro-poor expenditures continued to dominate general government spending with a share of 73% in 2014/15, or 12% of GDP.

Strengthening domestic-resource mobilisation to match rising fiscal expenditure is the centrepiece of the government's fiscal policy. Tax-revenue collection performance has thus seen significant improvement owing to the restructuring of the revenue collection organ of the government, the introduction of VAT along with modernised VAT-specific administration, greater automation and reallocating staff resources to higher value-added activities of the tax-collection system. As a result of pursuing prudent fiscal policy and of improvements in the tax administration and tax-collection systems, the fiscal deficit remains within an acceptable threshold. In 2014/15, the fiscal deficit declined to 2.0% of GDP from 2.6% in 2013/14. Nonetheless, the tax-revenue-to-GDP ratio remained low at 13.4% in 2014/15.

The government is undertaking additional reforms to further enhance efficiency in revenue mobilisation. A large share of domestic tax revenues is intended to be generated through non-distortionary taxes, notably VAT. In this regard, the government has started implementing a VAT system in major regional towns since the beginning of 2015. These measures are expected to curtail the major fiscal challenges, help to expand the tax base and, subsequently, increase the tax/GDP ratio to nearer the sub-Saharan Africa target of 18% in the medium term.

Table 3. **Public finances (percentage of GDP at current prices)**

	2006/2007	2011/2012	2012/2013	2013/2014	2014/2015(e)	2015/2016(p)	2016/2017(p)
Total revenue and grants	**18.6**	**15.5**	**15.9**	**15.1**	**16.1**	**14.5**	**14.2**
Tax revenue	11.0	11.5	12.4	12.7	13.5	12.1	11.8
Grants	4.8	1.7	1.5	1.1	1.3	1.0	1.1
Total expenditure and net lending (a)	**22.5**	**16.7**	**17.8**	**17.7**	**18.1**	**15.7**	**15.0**
Current expenditure	10.9	6.9	7.2	7.4	8.5	6.6	6.2
Excluding interest	10.1	6.6	6.9	7.0	8.1	5.9	5.5
Wages and salaries	6.5	3.3	3.6	3.6	5.2	3.6	3.3
Interest	0.8	0.3	0.3	0.4	0.4	0.6	0.6
Capital expenditure	11.6	9.8	10.6	10.3	9.7	9.2	8.8
Primary balance	**-3.1**	**-0.9**	**-1.6**	**-2.2**	**-1.7**	**-0.6**	**-0.1**
Overall balance	**-3.9**	**-1.2**	**-1.9**	**-2.6**	**-2.0**	**-1.3**	**-0.8**

Note: a. Only major items are reported.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Monetary policy

Ethiopia's 2014/15 monetary-policy stance was focused on maintaining price and exchange-rate stability, thereby creating a macroeconomic environment conducive to rapid and sustainable economic growth. To achieve these objectives, the National Bank of Ethiopia (NBE) effected a monetary-targeting regime, with a reserve-money target set to be consistent with developments in the other key sectors. In addition, the NBE's direct financing of the government was placed on a declining path in 2014/15. The NBE was also determined to ramp up efforts in managing domestic liquidity by adopting a robust liquidity forecasting and management framework and introducing indirect monetary instruments.

The NBE has also been monitoring monetary developments closely in order to achieve a single-digit inflation objective. Although inflation was contained at single digits, at 8.1% in 2013/14 and 7.7% 2014/15, it has tended to rise since June 2015 and reached 10.1% in December 2015. Food inflation has been on a continuous upward trend since the beginning of 2015 while non-food inflation has largely followed a stable trend. The NBE continued selling Treasury Bills mainly to mobilise non-inflationary resources to finance the fiscal deficit.

Institutional and regulatory reforms have also been implemented to improve the efficiency and soundness of the financial system in order to create a conducive environment for the private sector. The NBE continued to strengthen its financial-stability monitoring tools to preserve the stability and soundness of the banking system, which has been assessed to be liquid, adequately capitalised and profitable. To this end, the recently adopted risk-based supervisory framework, combined with regular on-site examination, has been utilised to mitigate any emerging financial risks. To mobilise savings and promote access to finance, the NBE continued to build on 2010/11 initiatives to promote financial inclusion, including the development of financial education and a consumer-protection strategy.

Although the local currency has continued to depreciate against the US dollar, the real effective exchange rate has been appreciating. Greater flexibility of the exchange rate is needed in the medium term to absorb exogenous shocks, support external competitiveness, and strengthen the position of foreign-exchange reserves.

Economic co-operation, regional integration and trade

Ethiopia is a member of the key regional groupings, including the Common Market for Eastern and Southern Africa (COMESA) and the Intergovernmental Authority on Development (IGAD), and it has signed all the regional integration protocols. The country has taken further steps since 2012 to facilitate increased regional trade with its neighbouring countries. Amongst recent steps was the signature of a Memorandum of Understanding (MoU) and a Transport Corridor Service Agreement with Kenya and South Sudan in 2014. This will help Ethiopia to spread the risks of relying too heavily on Djibouti for trading activities.

Ethiopia's exports continued to be dominated by primary commodities, as export diversification is still at a very early stage, and imports were dominated by capital goods, arising from growing demand for investment in infrastructure development. In 2014/15, Ethiopia's exports were valued at USD 3 billion, 8.5% less than in the previous fiscal year. This decline in the values of exports came mainly from drops in the export prices of gold, coffee and oilseeds, amongst other export products.

In the same period, imports were increased by 20.4% to USD 16.5 billion compared to the preceding year. The major imports were capital goods (41.9%), consumer goods (27.4%), semi-finished goods (15.7%) and fuel (18.5%). As a result, the trade deficit widened by 29.8% to reach USD 13.5 billion (21.5% of GDP) in 2014/15, in contrast to USD 10.4 billion in 2013/14.

Ethiopia is considered as having thick borders. In the World Bank report, *Doing Business 2016*, the country was ranked 166th out of 189 economies in the area of trading across borders, one place down from the previous year. In addition, measures to facilitate easy movement of persons and labour such as issuance of a common means of identification at the regional level, easing of visa requirements and the establishment of efficient immigration offices at border posts, with the required human and organisational capacities, are partially not yet applied.

Table 4. **Current account (percentage of GDP at current prices)**

	2006/2007	2011/2012	2012/2013	2013/2014	2014/2015(e)	2015/2016(p)	2016/2017(p)
Trade balance	-21.5	-17.3	-17.6	-19.0	-17.6	-17.2	-17.7
Exports of goods (f.o.b.)	7.7	7.7	6.6	6.0	4.5	4.0	3.7
Imports of goods (f.o.b.)	29.2	25.0	24.2	25.0	22.1	21.1	21.4
Services	-2.6	-2.0	1.0	1.0	-0.7	1.0	1.1
Factor income	0.2	-0.2	-0.2	-0.3	-0.5	-0.2	-0.7
Current transfers	19.2	12.4	7.6	7.4	4.1	8.0	8.1
Current account balance	**-4.7**	**-7.1**	**-9.2**	**-10.9**	**-14.6**	**-8.4**	**-9.3**

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Debt policy

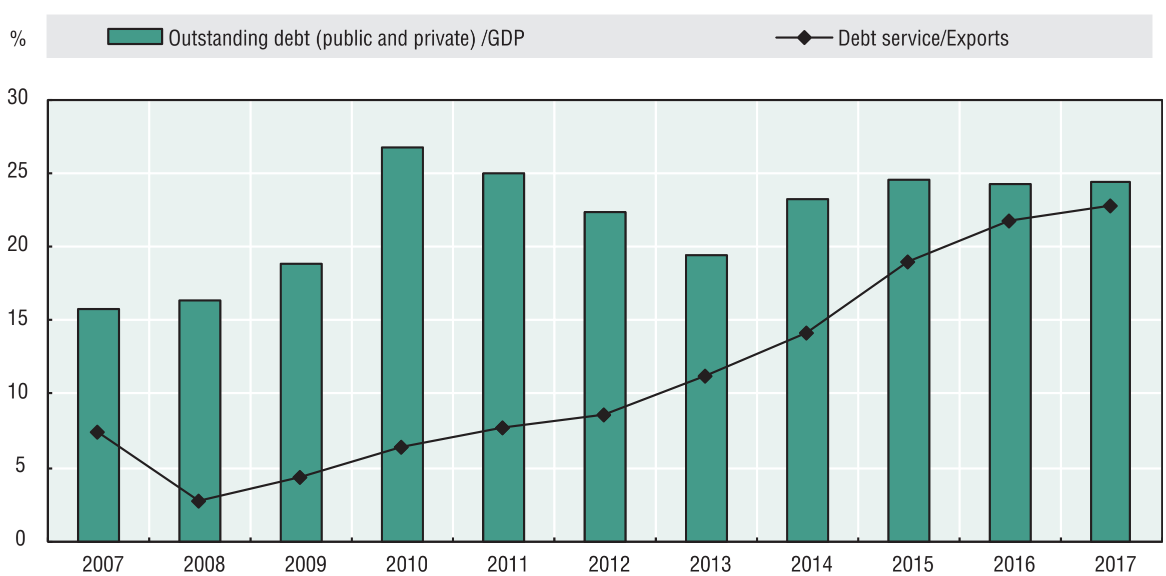
Since having received external debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006 and under the Heavily Indebted Poor Countries (HIPC) initiative in 2004, Ethiopia has generally been pursuing a sustainable debt management policy. Debt management has also been well co-ordinated with macroeconomic policies. The debt-management directorate of the Ministry of Finance and Economic Cooperation (MoFEC) is well established with good analytical capacity, as indicated by regular analytical reports on the external debt. Regular, comprehensive and accurate statistics are produced. The government produced a medium-term debt strategy

(2013-17) defining how the composition of the debt is projected to evolve over the medium term in financing the Growth and Transformation Plan (GTP). In addition, the legal framework for public borrowing is clearly defined, and information is shared amongst the different agencies responsible for contracting debts.

Nonetheless, debt-burden indicators in Ethiopia have been signalling a rising risk of debt-servicing difficulties, as public-debt levels began to grow immediately after the MDRI, and more so after 2010/11. Total public debt stood at USD 33.4 billion in 2014/15 (50% of GDP), compared to USD 25.4 billion in 2013/14 (40% of GDP). In 2014/15, out of the existing public debt, external debt amounted to about 57% while the share of domestic debt was 43%. This shows a significant increase in the domestic-debt portfolio, reflecting increased market activities and participation.

Ethiopia's external-debt stock has soared fivefold, from USD 2.8 billion in 2008/09 to USD 19 billion in 2014/15, up from 12.1% of GDP in 2009/10 to 26.2% in 2014/15. In 2014, the government floated a USD 1 billion ten-year international bond, the proceeds of which were used to finance infrastructure projects. The sharp increase in the external debt stock has primarily been driven by major import-intensive public-enterprise investments. The 2015 IMF rating of "moderate" risk of external debt distress in Ethiopia reflects the rise in public-enterprise debts and the weak export performance. The authorities recognise these challenges and to address them, they have set up a Ministry for Public Enterprises to monitor the operations of public enterprises closely, increase economic and export diversification, and focus on maximising domestic-resource mobilisation. The external debt also requires the export sector to grow, as the present value of the external-debt-to-exports ratio deteriorated from 424% in 2013/14 to 637% in 2014/15.

Figure 2. **Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Economic and political governance

Private sector

Accelerating the transformation of domestic entrepreneurs to enhance their competency and contribution is one of the GTP II pillars. This has reaffirmed the government's recognition of the private sector as an engine of growth. Ethiopia's investment laws have frequently been revised to improve the country's investment climate and promote a greater role of the private sector. In 2015, for example, the parliament approved laws that upgraded the Ethiopian Investment Agency to a Commission and amended the Investment Proclamation. The proclamation amendment introduced changes in the areas of investment open for investors and in the administration of industrial zones.

Licensing requirements for most activities have been streamlined. There are few barriers to entry and exit, and there is a favourable legal framework to address anti-competition behaviour by firms. The government has significantly reduced the cost of doing business by simplifying regulations and improving the quality and effectiveness of the institutions supporting businesses. The government and representatives of the private sector are implementing the MoU on the Public Private Dialogue forum signed in 2010. It is also carrying out at least two dialogue fora per year to solve problems encountered by the private sector.

Ethiopia's overall ranking in the World Bank report, *Doing Business 2016,* is 146th out of 189 economies, up from 148th the previous year. Improvements in Ethiopia's business regulatory environment have not been sustained, as evidenced by this low overall ranking. Ethiopia continues to fare relatively better in dealing with construction permits and enforcing contracts, ranking 73rd in dealing with construction permits and 84th in enforcing contracts. Starting a business, access to credit, protecting minority investors and trading across borders are major areas of weaknesses. The absence of a level playing field between state-owned and party-affiliated firms and private firms is also a hindrance to competition. According to the World Economic Forum's *Global Competitiveness Report 2015-2016* (2015-16 GCR), Ethiopia ranked 109th out of 140 countries, improved by 9 from its previous ranking. The most problematic factors for doing business in Ethiopia, according to the same report, are access to finance, inefficient government bureaucracy and foreign-currency regulation. Credit to the private sector as a percentage of GDP was only 9.3% in 2014/15, slightly up from 8.9% in 2012/13.

Financial sector

Ethiopia's financial sector includes banks, insurance companies, microfinance institutions and pension funds, with banks dominating the sector. There are 19 commercial banks operating in the country (3 state-owned and 16 private). State-owned banks claim about two-thirds of the market share in the sector. The total number of bank branches rose to 2 693 from 2 208 in 2013/14, 35.5% of which were in Addis Ababa, and the share of private banks was 58.1%. Hence the branches-to-population ratio went down to 33 448.2 from 39 833.8 the previous year. The total capital of the banking system reached ETB 31.5 billion (USD 1.6 billion), with private banks accounting for 56.5%. The Commercial Bank of Ethiopia, the biggest state-owned bank, accounted for 34% of the total capital of the banking system.

According to the IMF 2015 Article IV report, the system-wide capital-adequacy ratio of banks stood at a comfortable 16.6%. Return on assets and return on equity showed good performance, at 3% and 45%, respectively. The NBE regularly monitors banks' adherence to Basel I capital adequacy requirements, and virtually all commercial banks have risk-adjusted capital-adequacy ratios well above the minimum requirements of 8%. The loan portfolio of banks continued to be sound and the ratio of non-performing loans was low at 2.4%. Growth in deposits has been robust at 25.5% annual growth in 2014/15, mainly due to strong branch expansion and improvement in economic activities. For example, 485 bank branches were opened in 2014/15.

Despite the above, the financial sector is still shallow, offering a limited range of products and services. It remains closed to foreign investors, and formal capital markets are non-existent. Lending is mainly collateral-based and the vast majority of small entrepreneurs lack the necessary collateral. Furthermore, commercial banks continue to show little interest in serving early-stage firms, and small and micro enterprises that are beyond the domain of micro-finance institutions. According to the 2015-16 GCR, Ethiopia scored 3.3 out of 10 and ranked 116th out of 140 countries in financial-market development. In the World Bank report, *Doing Business 2016*, Ethiopia continues to underperform with respect to getting credit (167th out of 189 countries).

Public sector management, institutions and reforms

Government policies and strategies have put greater emphasis on the expansion of basic services and poverty reduction since 2004/05, and these have been backed by strong budget and spending commitments. Significant progress has been made in improving public financial-management systems since 2000 and especially since 2006, notably through the implementation of the Promoting Basic Services programme. A new reporting format showing financial and physical progress was rolled out. The government undertook an in-depth study on the challenges impacting internal audit, and based on this, a revised directive was prepared, which was awaiting approval in early 2016.

Anti-corruption campaigns have been intensified and a good number of government officials, including senior officials, have been prosecuted through the legal system. According to the Heritage Foundation 2016 Index of Economic Freedom, however, Ethiopia's 2016 economic freedom score is 51.5 (the same as in 2015), putting the country at 148th out of 178, in the "mostly unfree" section of the rankings. Ethiopia's regulatory system is generally considered fair. Secured interests in property are protected and enforced. Investment, business and other licenses can be obtained from the Ethiopian Investment Commission in a matter of hours. Proposed national laws are generally circulated for public comments prior to enactment. Disputes may be settled by means agreeable to both parties. Property and contractual rights are recognised and there are commercial and bankruptcy laws.

Nonetheless, non-state actors and citizens' representatives complain of inadequate access to information on government policies and lack of transparency in the government's decision-making process. Indicative of that, Ethiopia ranked very poorly (126th out of 140) in transparency of government policymaking in the 2015-16 GCR. The pervasive presence of state- and party-owned businesses distorts the perception of private owners of property rights and erodes policy credibility. On the property rights scale, Ethiopia ranked 92nd out of 178 countries in the Heritage Foundation 2016 index, and 107th out of 140 countries in the 2015-16 GCR.

Natural resource management and environment

Ethiopia has developed and implemented a range of legal, policy and institutional frameworks to address climate change, environmental protection and the sustainable utilisation of natural resources. The objectives of national policies are to promote sustainable utilisation of natural resources to support sustainable growth and poverty reduction. The policies are integrated into sectoral policies and implemented at federal, regional and district levels. In addition, GTP I and II accorded priority to the environment for sustainable development. The intervention strategies focus on improving watershed management, afforestation, and soil conservation.

Ethiopia has a vision of becoming a middle-income and carbon-neutral economy by 2025. The implementation of the Climate-Resilient Green Economy (CRGE) strategy developed in 2011 is geared to meeting this ambition. The CRGE strategy has set out a comprehensive strategy to develop the economy in a manner that minimises the economy's susceptibility to, inter alia, climate change, and this strategy has been implemented through GTP I.

Despite these plans and policy frameworks, Ethiopia still faces serious challenges from changing climate conditions, calling for continuous adaptation and support to develop on a low-carbon trajectory. The Intended Nationally Determined Contribution (INDC) published in 2015 in the run-up to the Paris Climate Change Conference builds on the CRGE strategy and explains how Ethiopia plans to utilise international financial support to remain a very low emitter of greenhouse gases (GHGs) and to become a very efficient economy in terms of GHG emissions per person and per unit of GDP. At the end of GTP II, the government anticipates reducing GHG emissions by 147 million metric tonnes.

Political context

Ethiopia is a relatively stable country. Following the death of Prime Minister Meles Zenawi in 2012, there was a smooth transition of power to the current premier, Hailemariam Desalegn, who retained the premiership in the government set after the May 2015 general election. The government is formed on the basis of multiparty elections held every five years. The fifth national elections took place in May 2015 and the ruling Ethiopian People's Revolutionary Democratic Front was kept in office. African Union observers declared the election to have been generally fair, while opposition parties and activists viewed the election results as an indication of a narrowing democratic and political space in the country.

Ethiopia compares unfavourably with some African countries, including its East African peers, on political stability, and voice and accountability. The country's political stability is further threatened by, amongst others, regional insecurity and fragilities, and their resulting spill-over effects. Ethiopia is currently hosting approximately 825 000 refugees from neighbouring countries (Somalia, Sudan, South Sudan and Eritrea).

Ethiopia plays an important political role in the Horn of Africa through its engagement in many regional peace- and stability-building initiatives. Ethiopia is currently the chair of IGAD, through which it has been playing an important mediation role in the South Sudan conflict. It is also actively engaged in post-conflict reconstruction efforts in Somalia, and general counterterrorism initiatives. Looking forward, widening its political and democratic space, and addressing regional and local sources of instability will remain key challenges for the country.

Social context and human development

Building human resources

Ethiopia's strong growth over the past decade has helped to achieve significant gains in human development. Between 2000 and 2014, Ethiopia's Human Development Index value increased from 0.284 to 0.442, indicating an average annual increase of 3.21%. According to a 2014 assessment of progress in the Millennium Development Goals (MDGs) in Ethiopia, six of the eight MDGs were either achieved or in progress to being achieved by the end of 2015. Impressive results in health-service expansion have also been achieved. According to official national data, the contraceptive prevalence rate increased to 41.8% in 2014 from 29% in 2011, and coverage of antenatal visits reached 39.6% in 2014, up from 34% in 2011. The rate of deaths amongst children under five declined from 123 per 1 000 live births in 2005 to 60 in 2015. Infant mortality dropped from 77 to 59 per 1 000 live births between 2005 and 2014. The primary-school net enrolment rate increased from 68% in 2004/05 to 92.6% in 2013/14. The completion rate of grade eight students increased from 46.7% in 2009/10 to 48% in 2013/14, not yet high enough to achieve the education goal. Literacy rates have risen since 2004 from 38% to 46.7% in 2011. There is a parallel drive to expand vocational training and tertiary education in order to provide students with skills needed by the economy.

Combating HIV/AIDS, malaria, tuberculosis and other diseases has been prioritised in the national development plans. The challenges posed by HIV/AIDS have continued to be addressed through instituting HIV/AIDS policies, strategies and programmes. Ethiopia has achieved excellent results at the country level to scale up effective coverage and services, and with its commitment to universal access to HIV prevention, treatment, care and support. As a result, Ethiopia has succeeded in reducing the HIV/AIDS prevalence rate from 4.5% in 2000 to 1.1% in 2014, which surpasses the MDG target of less than 4.5%. There has also been progress in controlling malaria and tuberculosis. By 2010, all residents of malaria-prone areas had an insecticide-treated net against anopheles mosquitoes. The percentage of the population with treated bed nets reached 45% in 2014, up from 22% in 2010.

The MDG target that was not achieved by 2015 was that of reducing maternal mortality, which has not improved appreciably since 2010/11. Maternal mortality remains high at 420 deaths per 100 000 live births. The government plans to prioritise redressing this problem during GTP II. Another development challenge is the persistence of regional disparities, especially in emerging regions like Afar and Somali.

Poverty reduction, social protection and labour

With the government's consistent implementation of its poverty-reduction strategy, pro-poor spending continues to rise (73% of total public expenditure in 2014/15). As a result, poverty in Ethiopia has declined at an annual average of 1.94% since 1995. The population share of persons living below the national poverty line fell from a baseline of 48% in 1990 to 45.5% in 1996 and 29.6% in 2011, and is estimated to have further declined to 23.4% in 2015, which is below the MDG target of 24%. The sharp decline in poverty is attributable to the implementation of welfare programmes such as the Productive Safety Net Programme (PSNP), other food-security programmes as well as of urban food-distribution and subsidies. PSNP beneficiaries are nearly 8 million chronically food-insecure individuals, and the programme has a strong focus on addressing the poverty of female-headed households and on encouraging women's participation in public-works activities. In 2015, Ethiopia was facing drought due to the effects of El Niño, and 10.2 million persons were in need of emergency aid into 2016.

Inequality measured by the Gini coefficient has remained low and stable, broadly constant at 0.3 in since 2004/05, while the urban Gini coefficient declined to 0.37 in 2010/11 from 0.44 in 2004/05.

Despite all this, Ethiopia is amongst the poorest countries in the world, with a very low human-development ranking, or 174th out of 188 countries according to the United Nations Development Programme's *Human Development Report 2015*. About 23 million Ethiopians live in conditions substantially below the basic poverty line and food insecurity remains a major challenge. According to the same report, 44.2% of children under five are malnourished and stunted. Poverty is mostly a rural phenomenon, as the share of the population below the poverty line in rural areas stood at 30.4%, while it was 25.7% in urban areas. The age-old structural problems of the agriculture sector are the main reason for the higher incidence of poverty in rural areas. Spatially disaggregated poverty analyses also indicate marked disparities amongst regions, largely attributed to differences in stages of development and to resource endowments. In 2010/11, the poverty headcount index was the highest in the Afar region (36.1%) followed by the Somali (32.8%) and Tigray regions (31.8%), while poverty estimates were lowest in the Harari region (11%) followed by the cities of Addis Ababa (28.1%) and Dire Dawa (28.3%). For poverty to decline significantly, there has to be a concerted effort and perhaps a new approach to address the structural problems of the agriculture sector.

A comprehensive social-protection policy of the country was approved by the Council of Ministers in 2014. Labour-market regulations are broadly appropriate and enforced for an increasing number of workers. Active labour-market programmes (linking micro and small-scale enterprises with public works like paving and urban housing construction) are improving in quality and coverage, although weaknesses remain. The government had created more than 1.4 million jobs in 2014/15 through its support to micro and small-scale enterprises.

The government has ratified the various ILO labour conventions, including ILO Convention 182 on the Worst Forms of Child Labour. Enforcement of these conventions, especially the child-labour convention, is however rather weak.

Gender equality

The government considers gender as a cross-cutting issue and works to make sure that gender is integrated into policy strategies and programmes. Accordingly, addressing gender equality and women's empowerment is one of the pillars of the GTP. The Ministry of Women, Children and Youth Affairs and its regional bureaus are responsible for integrating gender into their respective areas of mandate.

The gender parity index in primary-school enrolment reached 0.93 in 2014, up from 0.7 in 2000. The share of married women using a modern contraceptive method more than tripled, from 13.7% in 2005 to 40% in 2014, thanks to a sharp increase in the use of contraceptive injections from 3% to 31% in the same period. Access to health care for women has been improving rapidly as in 2014, 41.8% of Ethiopian women gave birth with a skilled health professional in attendance, compared to only 29% in 2011. The percentage of seats held by women in the national parliament was 38.7% in 2015, compared to 27.8% in 2010. The participation rate of women in business and decision making, however, is low. The literacy level of women is markedly lower than that of men (63% for men and 47% for women).

Thematic analysis: Sustainable cities and structural transformation

With an officially estimated total population of 90 million in 2015, Ethiopia is the second most populated country in Africa after Nigeria. Urbanisation stood at 19%, significantly below the sub-Saharan average of 37% according to World Bank 2014 data. About 80% of the population resided in rural areas and derived its means of living from subsistence farming. Agriculture is the foundation of the Ethiopian economy. It contributes to 38.8% of GDP and employs over 80% of the labour force, 90% of which are small-scale farmers. Arable land is highly fragmented and under-utilisation of appropriate agricultural technologies has destined the country for food insecurity. This clearly sets the demographic landscape of the country.

Since 2005, however, Ethiopia's urban population has been increasing rapidly. According to projections by the Central Statistics Agency of Ethiopia (CSA), the urban population is growing by 3.8% per annum, which is higher than the 2.5% population growth rate, and this rate will be tripled by 2037. A study by the World Bank (2015) indicates that the rate of urban growth will be even faster, at about 5.4% per annum, and the urban population will reach 30% by 2028 and be tripled by 2034. The major drivers of urbanisation in Ethiopia are: i) natural growth; ii) migration to urban centres and the reclassification of villages into towns; and iii) the expansion of urban centres. Studies have estimated that the natural increase of urban population is responsible for about 40% of the current growth in urban population, whereas migration and reclassification of villages into towns are responsible for 33% and 24%, respectively, of the growth. Expansion of urban centres to obtain land for manufacturing and similar demands is responsible for less than 4% of the growth.

The government recognises that rapidly growing urbanisation plays a considerable role in transforming the economy because, like in other countries, urban centres are hubs for innovation, diversification and industrialisation, with higher chances for creating jobs. GTP II also emphasises the expansion of the manufacturing sector in line with rapid urban growth since urban centres with their better infrastructures can facilitate the flourishing of service and industrial sectors and could absorb migrant labour from rural parts of the country. The government also recognises that rapidly growing urbanisation is both an opportunity and a challenge. As an opportunity, it is a chance to promote a dynamic self-sustaining urbanisation process, which is an integral part of the overall economic structural transformation in the country. According to the World Bank study, even though the country's urban centres comprise only 20% of the population, their contribution to GDP stands at 38%, and 60% of all new jobs created in the country between 2005 and 2011 were in urban centres. On the other hand, as a challenge, it demands attention and investment to establish basic infrastructure such as health, education, housing, roads, water and sewerage, and recreational facilities. Without these necessary preconditions urban growth can create havoc that may result in poverty, unemployment, hopelessness, criminality and social evils. In most of the country's urban centres, there is the gap between the demand for utility services and their supply.

According to the CSA survey, about 25.7% of the urban population lives below the national poverty line, and 46.4% is multidimensionally poor. Housing quality in Ethiopia is lower than in neighbouring countries, and overcrowded living conditions are the major housing challenges in large urban centres. The same 2015 World Bank study indicates that 70-80% of the population lives in what might be considered slums, and 60% of urban houses are slums. Coverage for sanitation services is very low; only 27% of urban dwellers had access to improved sanitation facilities in 2015. Solid-waste management is also a big challenge; it is often discharged into open areas, endangering public health. Traffic accidents are very high in urban areas. Urban inequality measured by the Gini coefficient is high, even though it declined in recent years from 0.44 in 2005 to 0.37 in 2011.

Strong municipal institutions and efficient manpower that can mobilise financial resources and allocate budgets effectively are thus essential to establishing proper urban management. Generally speaking, municipal finance in Ethiopia is inadequate to finance urban developments, including infrastructure and services. Transfers from the federal government and own revenues are the major sources of finance to run municipal institutions. In 2015/16, most towns and cities derive their own revenue share of the budget resource from the leasing of land to cover their municipal costs, a system not yet efficient and reliable due to the sluggish pace of the land-auction process.

The government has an urban-development policy but not a consolidated strategy. One of the pillars of GTP II is managing rapid urban growth and increasing the urban contribution to economic growth. Under the strong vision and leadership of the Ministry of Urban Development, Housing and Construction, commendable progress has been made in shaping urban developments in Ethiopia. The main urban transport systems are city buses, taxis and private vehicles, and in 2015 a light rail system was made operational in Addis Ababa, with two main lines serving the city, one north to south and one east to west. The government has given attention to housing development, upgrading slums, providing infrastructure and promoting small urban-based enterprises since 2005. It has been implementing an Integrated Housing Development Programme (IHDP) since 2005, and about 210 000 low-cost condominium housing units in 56 cities have been constructed and transferred to beneficiaries, and 740 000 jobs have been created, which is believed to have contributed to enhancing the savings habit of urban dwellers and to reducing urban poverty.

Until 2012/13, growth in Ethiopia has been based on primary economic activity with no value addition. It has been leaning heavily on agriculture, and as such it has not been sustainable. A greater share of the economy should go to the service and manufacturing sector so that structural transformation can materialise. Urbanisation plays a proven viable role with its multifaceted benefits. Therefore, to attain sustainable economic growth, which relies primarily on industry and services, the urbanisation process should be supported with proactive and dedicated municipal work.