DEVELOPMENT BRIEF

Empowered lives.
Resilient nations.

ANALYSIS OF THE OVERALL DEVELOPMENT FINANCING ENVELOPE IN ETHIOPIA & IMPLICATIONS FOR THE UN

UNDP ETHIOPIA
NO. 2/2015

ETHIOPIA

Development Financing

United Nations Development Programme

Analysis of the Overall Development Financing Envelope in Ethiopia and Implications for the UN

1.0 Overview

Ethiopia has experienced a decade of robust growth with a GDP growth rate averaging over10 percent compared to a 5 percent average recorded for sub-Saharan African countries. This makes Ethiopia one of the fastest growing economies in the world and within the growth target for achieving the MDGs by 2015. The Government must keep pace with the key objectives of the Growth and Transformation Plan (GTP) (2011-2015), inter-alia, to achieve broad-based, accelerated and sustained economic growth for poverty eradication in order to achieve the transformational agenda. Building on the success of the Plan for Accelerated and Sustained Development to End Poverty that had achieved significant human and social development, the GTP prioritizes areas including agriculture and rural development, industrial growth, infrastructure development, human development as well as good governance and democratization. Balancing the macro-economic objectives of maintaining low inflation and meeting the ambitious targets of the GTP in a global environment of declining ODA flows therefore becomes a complex enterprise. This paper looks at the overall financing envelope against a backdrop of the competing demands for investment in infrastructure and the social and human development sectors. In essence the implementation of the current GTP and its successor plan requires mobilization of considerable additional financial resources.

Given the above background, it is apparent that development financing remains one of the critical drivers of achieving the GTP targets. The 2013 Annual Progress Report on the GTP and previous reports have demonstrated slippages in several fronts (i) the slow pace of structural transformation with industrial sector accounting for only 12.4 percent of the GDP (ii)[1] widening fiscal deficit at 2 percent of GDP in 2013 compared to 1.2 percent in 2012 and estimated to increase to 6 percent by 2016 (iii) low tax to GDP ratio of 12.5 percent compared to GTP target of 15-17 percent

[1]Due to lack of data for State Owned Enterprises (SOEs) this figure may not fully show the overall fiscal stance on the deficits

(iv) decline in export earnings that stood at USD 3.1 billion in 2013 in contrast to USD3.2 billion last year and the annual GTP target of USD 6.5 billion and (v) less than appreciable level of domestic savings at 17.7 percent of GDP while the gap between domestic savings and gross domestic investment remains high at over 15 percent.

Impressive and considerable progress has been achieved in human development terms, with Ethiopia on track to meeting six of the eight MDGs, and being recognized by the Human Development Report as one of the top movers of human development values over the past decade. These improvements are due to big public investments over the past decade in infrastructure and social services, notably education, health, and pro-poor safety nets. Still, challenges remain. There are genuine concerns with regard to issues of quality of basic services, such as education and health services among pastoral communities and emerging regions such as Afar, Somali and Gambella. This is coupled with wide gender disparities in education, health and labor markets. According to available data, Ethiopia has one of the highest maternal mortality ratios in the world. Generating productive employment, especially among youth, remains a serious challenge, not least given the large cohorts of students who will be graduating annually from universities in the coming years

To fully understand the scope and extent of the financing for development envelope that is available, we examine the various financing tools, including their trends and magnitudes to show the resource gap and identify potential financing schemes. The objectives of the study are to better understand how the financing envelope is used to support development interventions and to help provide information for the UN to engage in policy dialogue with government on financing for development options. It will assist to identify the resource gaps and provide policy advocacy and strategic interventions that could reinforce support towards sustaining the growth trajectory and boost human development.

The rest of the paper is structurally organized as follows: section two constitutes the analysis of the financing envelope; section three focuses on options for development financing, and section four looks at recommendations.

Section II: Analysis of Financing Envelope in Ethiopia

2.1 Domestic Resource mobilization

The Government prioritizes the use of domestic resource mobilization tools as vehicles for financing its development. This includes tax collection, non-tax revenue, domestic borrowing, and other domestic income sources. The analysis also delves into resource mobilization by regional governments, mobilization of resources through corporate bonds (Saving Bonds, Power Bonds, Diaspora Bonds, NBE bond, etc) and the remittances for financing the foreign exchange component in the medium-term. Enhancing domestic resource mobilization is pivotal to ensure sustainable high rates of growth. Unlike foreign aid and FDIs, domestic finances are more predictable, reliable and can be directed to desired sectors. Moreover, other countries' experiences indicate that relying on domestic resources is essential to solidifying ownership over development strategies and strengthening the bonds of accountability between government and citizens. Cognizant of this fact, Ethiopia has in the past decade significantly enhanced its domestic resource mobilization with significant increase in tax collection through institutional reforms, improvement in tax administration, and trade facilitation. In 2012/13 for instance, total Government revenue and grants was Birr 137.2 billion (16.1% of GDP) of which 91 percent or Birr 124.1 billion (14.6% of GDP) was collected from domestic sources in contrast to 12.1% of GDP in 2008. However, this is against realized total expenditure of Birr 153.9 billion (18.1% of GDP) with the deficit financed by net external debt.

a) Trends in Federal Government Budget

Government approved a federal budget of Birr 178.6 billion (USD 9.1 billion)[2] for fiscal year 2014/15 [3] in contrast to Birr 154.9 billion for the preceding fiscal year, posting annual increase of 15.3%. The budget does not include regional governments' budgets from their own revenues and public enterprises' budgets. This budget is divided into Birr 96.6 billion (45.9%) recurrent expenditure budget (that includes Birr 51.5 billion transfers to regional governments) and Birr 82 billion (54.1%) capital expenditure budget. The capital budget includes Birr 15 billion allocated for supporting achievement in

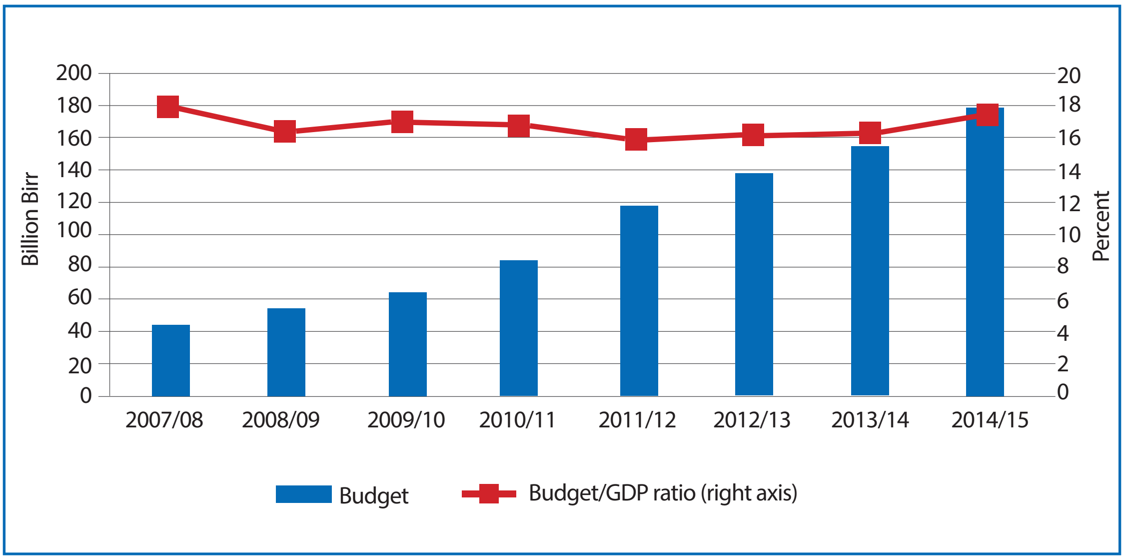
[2] Converted using the official exchange rate of 1USD = Birr 19.60on July 7, 2014, end of year rate

[3] The Ethiopian fiscal year runs from July 8 to July 7 of the next year

the MDGs that should be transferred to regional governments for their capital expenditure related activities towards the achievement of the MDG targets. Over 70 percent of the budget is allocated for pro-poor sectors or poverty reduction activities. It is envisaged that 80.8% of the financing would come from domestic sources; external grants (Birr 16.8 billion) and external loans (Birr 17.5 billion) accounted for 9.4% and 9.8%, respectively. (Note: The Birr 16.8 billion external grants and most of the Birr 17.5 billion in loans is ODA which is on budget; hence there is a difference between the amount and total ODA flows. This is an important accountability feature as it is the development assistance over which Government has a clear purview and must show accountability to its citizens.)

Growth in the nominal federal budget averaged 23% in the past five years. The budget as a ratio of GDP however declined from 17.9% to 16.3% between 2008 and 2013. Figure 1 below depicts trends in the level of federal government budget and its ratio to GDP.

Fig 1. Trends in annual budget and as a ratio of GDP

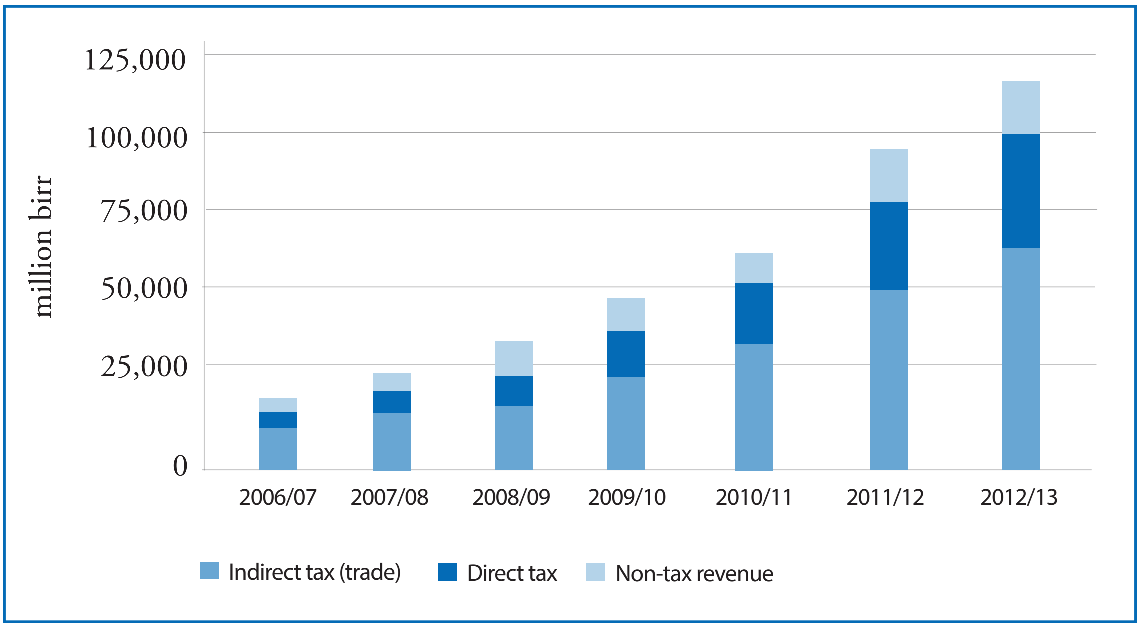


Looking at the trends in budget allocation, while the share of recurrent budget declined from 56.9 percent in 2007/08 to 54.1 percent in 2014/15 the capital budget share increased from 43.1 percent to 45.9 percent in the same period. Close to one-third or 28.8 percent of the total budget is transferred as regional subsidies that are allocated to the regional states based on the grant formula developed and approved by the House of Federation. Government has also been allocating budgetary resources to the achievement of the MDGs in the past four fiscal years. For 2014/15 Birr 15.0 billion or 8.4% of the total budget was earmarked for achievement of the MDGs.

b) Tax and non-tax revenues

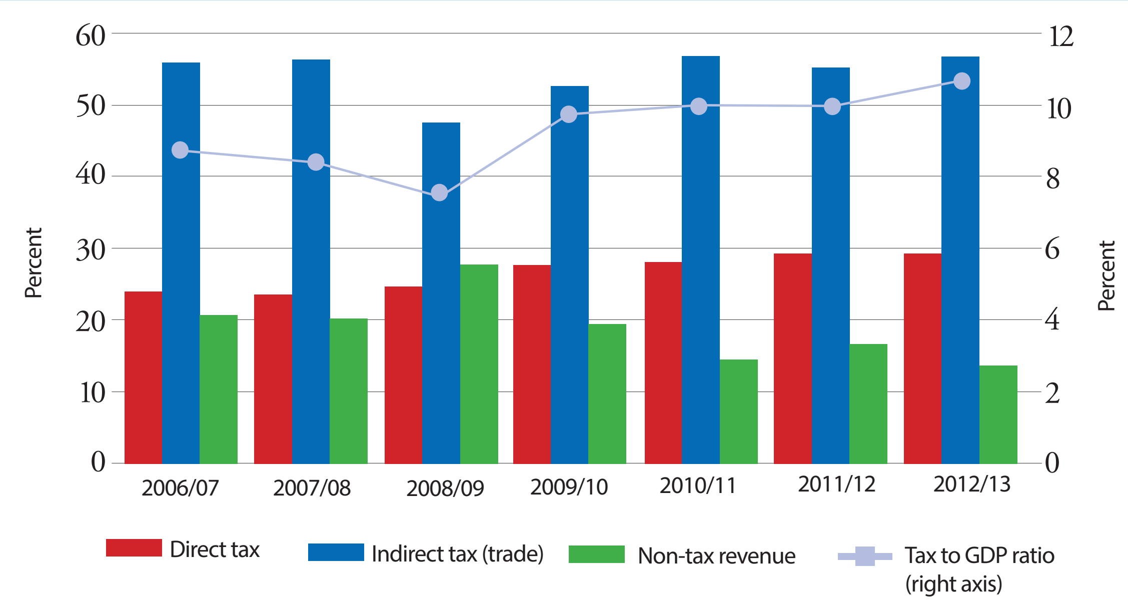
Domestic revenue has increased by more than twofold - from Birr 53.9 billion in 2009/10 to Birr 124 billion in 2013 and it buoyed by expansion in tax collection from Birr 43.3 billion to Birr 107 billion in the same period, indicating that tax revenue accounts for over 86 percent of total domestic revenue. As in many developing counties, the share of indirect taxes, which is mainly trade tax, takes up the lion's share, at nearly 60 percent of total collected taxes. Nevertheless, domestic revenue as a ratio of GDP had slightly increased from 14.2% in 2009/10 to 14.6% in 2012/13 and tax revenue as a ratio of GDP from 11.4% to 12.5% in the same period which is way below the GTP target of 15 percent and the sub-Saharan African average of over 20 percent. Figure 2 and 3 below depict trends in domestic revenue and the share of

Figure. 2. Domestic revenue



Source: MoFED 2012/13

Fig 3. Source of revenue as % total domestic revenue



Source: MOFED 2012/13

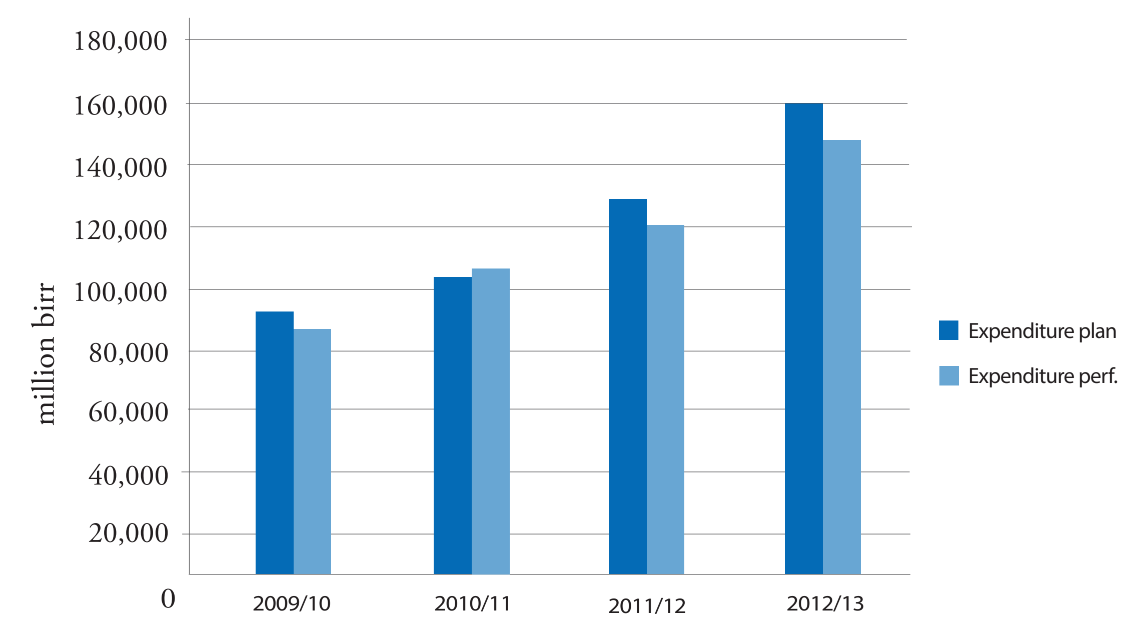
Government revenue collection and expenditure performance as shown in table 1 below indicates that the fiscal deficit is sustainable and it remains well below 3 percent of GDP as planned in the GTP. Similarly, comparisons of revenue and expenditure plans against their performances are shown in figure 4 and 5. Fiscal performance against GTP targets indicates fiscal prudence during the GTP period.

Table 1: Government revenue and expenditure performance (ratio of GDP

Indicator	2009/10	2010/11	2011/12	2012/13
Domestic Revenue and Grants	17.5	16.9	15.7	16.1
Domestic Revenue	14.2	13.7	13.9	14.6
Regional governments	2.6	2.5	2.7	3.4
Grants	3.3	3.3	1.7	1.5
Expenditure	18.8	18.6	16.8	18.1
Recurrent expenditure	8.4	8.0	7.0	7.4
Capital expenditure	10.4	10.5	9.9	10.7
Fiscal balance	-1.3	-1.6	-1.2	-2.0

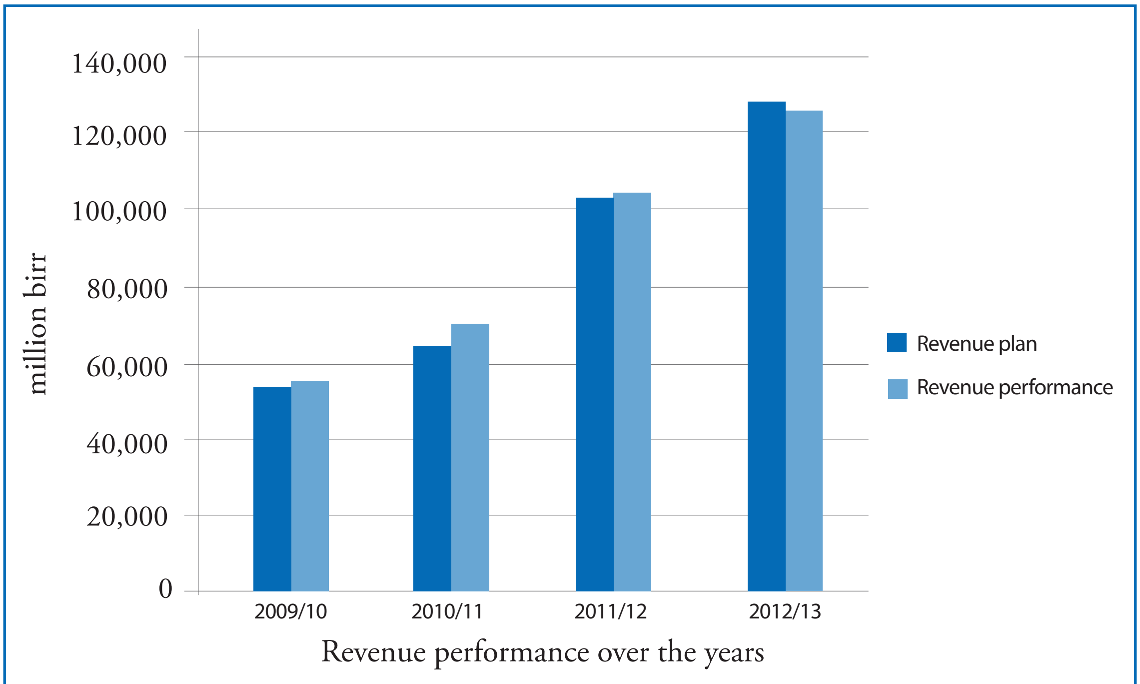
Source: MOFED 2012/13

Figure 4: Government total expenditure plan and performance during the GTP



Source: MoFED 2012/13

Figure 5: Gov't revenue plan and performance during GTP



Source: MoFED

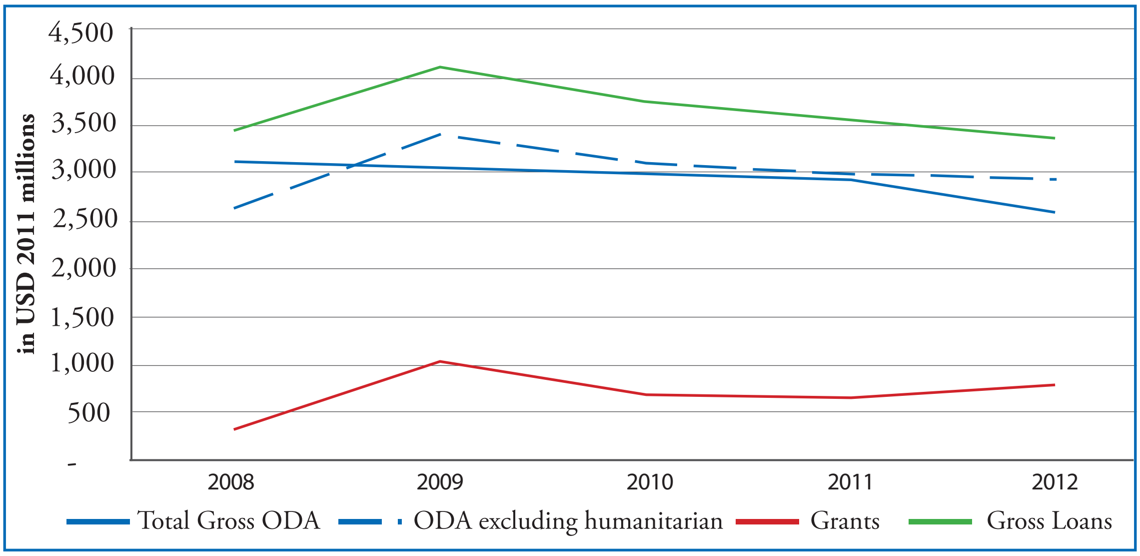
c) Domestic Borrowing (Bonds)

Apart from the recurrent and capital expenditure budgets incorporated in the federal budget of the government, the GTP also encompasses ambitious targets in physical infrastructure such as roads, railway, energy generation, telecommunications, and urban housing. Public enterprises and institutions such as EEPCo, Development Bank of Ethiopia, Saving Houses Development Enterprise, Railway Corporation, and Regional Governments have raised financing through issuing various corporate bonds to domestic banks. The total face value of these issued bonds increased from Birr 27.7 billion in June 2010 to Birr 95.1 billion in December 2013, indicating that Birr 67.4 billion domestic financing was raised during the GTP implementation period from domestic banks.

2.2 Analysis of the sectors supported by Donors

In 2012, official development assistance disbursed to Ethiopia was USD 3.3 billion, a decrease of 6 percent compared to 2011. Figure 5 below illustrates the level of gross ODA from bilateral and multilateral partners over a five-year period. Grants decreased by 11 percent while concessional (soft) loans increased by 18 percent to make up 23 percent of total ODA to Ethiopia. While the overall volume of aid remains significant, Ethiopia's aid per capita of USD36 remains below the sub-Saharan average of USD49.

Figure 6: Total development assistance in Ethiopia as reported to the OECD-DAC

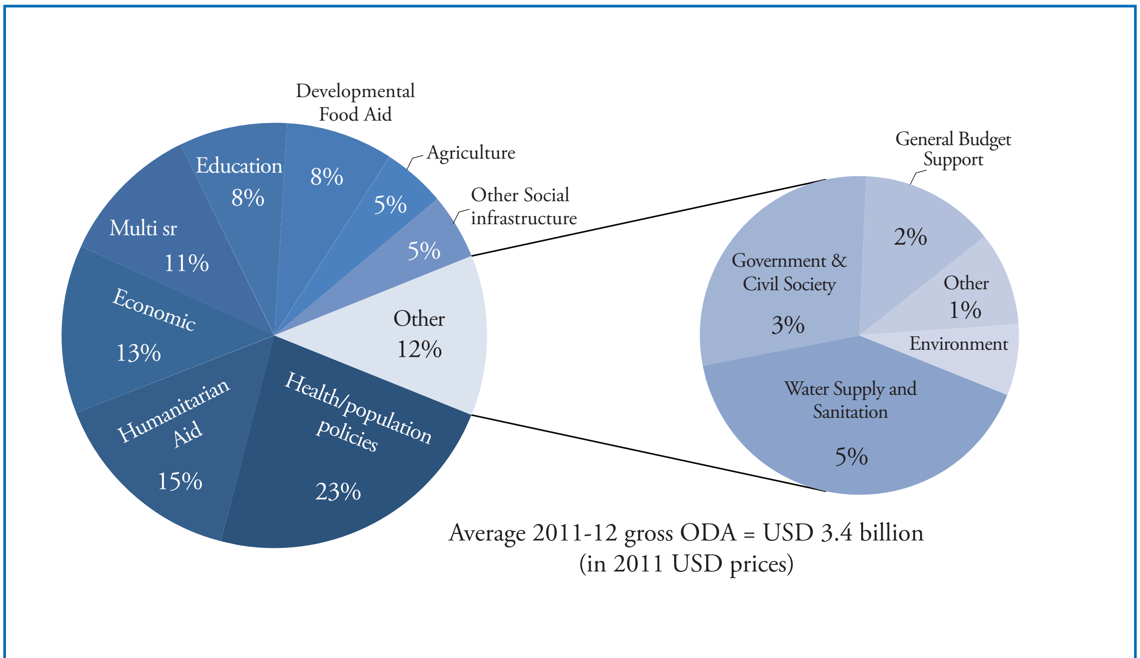


Source: OECD DAC aggregates, Paris, 2014.

Among bilateral and multilateral development partners in 2012, investments in health and population policies account for close to one-quarter (23 percent) of total development assistance, followed by humanitarian assistance (15 percent). Economic infrastructure (13 percent); multi-sector aid (11 percent); education (8 percent); developmental food aid (8 percent); agriculture (5 percent); other social infrastructure (5 percent); water and sanitation (5 percent); government and civil society (4 percent); and other (4 percent) round out the remaining sectoral distribution (see Figure 7).

While bilateral agencies provide most of their assistance to health and agriculture interventions, the majority of the European Union's investments went towards economic infrastructure,(transport and energy generation and supply) and international financial institutions' support went towards multi-sector programs, agriculture, and economic infrastructure. The United Nations family disburses most of its development assistance to health, agriculture, education and water and sanitation.

Figure 7: Sector distribution of development assistance in Ethiopia as reported to the OECD-DAC



Source: OECD Creditor Reporting System, Paris, 2014.

Table 2: Sectoral distribution of development assistance in Ethiopia as reported to the OECD-DAC (in 2011 USD millions)

Sectors	2008	2009	2010	2011	2012
Agriculture	77	418	150	147	181
Developmental	340	218	362	276	284
Food Aid Economic	476	634	390	474	406
Infrastructure Education	150	348	284	292	273
Environment	16	16	18	28	32
General Budget Support	0	178	179	115	-
Government and Civil Society	209	145	133	117	124
Health	178	317	227	369	377
Humanitarian Aid	823	701	639	595	436
Multi sector	272	515	304	354	392
Other Production Sectors (forestry, fishing, industry, mining, construction, trade policy, tourism)	21	34	54	29	24
Other Social infrastructure	264	128	280	163	181
Population Policies and Reproductive Health	356	265	524	449	380
Water Supply and Sanitation	89	123	125	149	193
Other (admin., promotion development awareness, refugeees in donor countries)	30	15	15	11	16
Total	3,300	4,054	3,684	3,567	3,300

Source: OECD Creditor Reporting System, Paris, 2014.

Over 30 active development partners operate in Ethiopia and include bilateral and multilateral partners as well as providers of south-south and triangular cooperation. Based on average disbursements in in 2011 and 2012, the largest donor is the World Bank (IDA) – USD734 million per annum, followed closely by the United States – USD720 million; United Kingdom (DFID) – USD487 million; EU institutions – USD226 million; and the African Development Bank – USD167 million. Including both core and non-core resources, five UN agencies (WFP, UNICEF, IFAD, UNDP and UNFPA) together disbursed an average of USD603 million in 2011 and 2012, positioning the UN system among the largest providers of development assistance in Ethiopia.

2.3 The role of non-traditional donors in financing development

It is critical to examine the role of non-traditional donors in the financing of development in Ethiopia. Ethiopia's demand for external finance to meet its ambitious GTP exceeds what is available from OECD-DAC donors. As Prizzon and Rogerson (2013) reflect in their case study on the broader aid landscape, the government increasingly relies on other sources of development assistance, including from non-DAC donors such as China and India, philanthropic organizations such as the Bill and Melinda Gates Foundation and even new 'social impact investors' such as the Shell Foundation and the Acumen Fund.

As seen in Table 3. China and India in particular are important sources of financing Ethiopia's development in the areas of infrastructure. Ethiopia's cooperation with China is perceived as a win-win type of arrangement. China wins because it sells its financial services and in turn employs Chinese companies (private and state-owned). Ethiopia wins because it is able to realize large infrastructure projects. The Ethiopian Government appreciates the fact that Chinese companies are ready and well positioned to implement projects financed by China given Ethiopia's own nascent domestic private sector. Only a handful of OECD/DAC and multilateral partners provide official loans, (African Development Bank, Arab Bank for Economic Development in Africa (BADEA), IFAD, Italy, OFID, World Bank) and the fact that China does so without political conditionality is another factor that endears Chinese investment to the Government.

Table 3: Development Finance in Ethiopia by non-OECD Development Partners

(in USD millions)	2011/12	2012/13	Average
China	**74.3**	**152.06**	**113.18**
Agriculture	0	0.05	0.025
Multisector	0	2.00	1.00
Transport/storage	74.3	119.97	97.135
Water supply / sanitation	0	30.05	15.025
India	**59.02**	**26.66**	**42.84**
Energy generation / supply	0.08	0	0.04
Industry	58.95	26.66	42.805
Kuwait Fund for Arab Economic Development	**5.86**	**2.58**	**4.22**
Energy generation / supply	1.53	0	0.765
Transport/storage	4.34	2.58	3.46
Saudi Arabia	**0.02**	**0.46**	**0.24**
Transport/storage	0.02	0.46	0.24

Source: MoFED (December 2013).

2.4 Climate Finance

According to a collective commitment by developed countries on fast-start finance, climate change finance in Ethiopia is "new and additional resources." In reality, it is very difficult to conclude that climate finance has been additional to previous development finance given the overall trends in development finance to Ethiopia, which includes climate change adaptation interventions, as well as officially-funded mitigation measures. Notwithstanding this fact, Ethiopia is the 13th-largest recipient of climate finance at the global level and the second largest recipient in Sub-Saharan Africa after Kenya, having received a total so far of $107 million in commitments since 2003 (Prizzon, 2013).

2.5 UN Contribution to the Overall Resource Envelope

The paper also examines the UN contribution to the overall resource envelope in Ethiopia. Table 4 below indicates that UN total contributions both for on and off budget was approximately USD 400 million 2011/2012. The aid on budget provided by the United Nations – meaning the volume included in the budget proclamation approved by Parliament – constituted USD 43.5 million according to the recent post-Busan monitoring Survey report based on 2011/12 data, and reached USD 91 million in 2013/14. Including both core and non-core resources, five UN agencies (WFP, UNICEF, IFAD, UNDP and UNFPA) together disbursed an average of USD 603 million in 2011 and 2012, positioning the UN system among the largest providers of development assistance in Ethiopia.

Table 4: ODA disbursement for GTP period in USD

UN agency	2010/11	2011/12	2012/13	Total
FAO	6.2	5.1	7.4	18.7
GEF	0	0.1	-	0.1
Global Fund	235.1	66.1	-	301.2
ILO	0	-	-	0
UNICEF	108.4	63.5	160.4	332.3
UNDP	43.1	39.8	35.9	118.9
UNESCO	0.2	-	-	0.2
UN Women	-	1.2	0.5	1.8
UNIDO	0.3	-	-	0.3
UNFPA	8.3	18.4	12	38.7
WFP	171.9	201.9	63.8	437.6
Total	573.5	396.2	280.1	1249.8

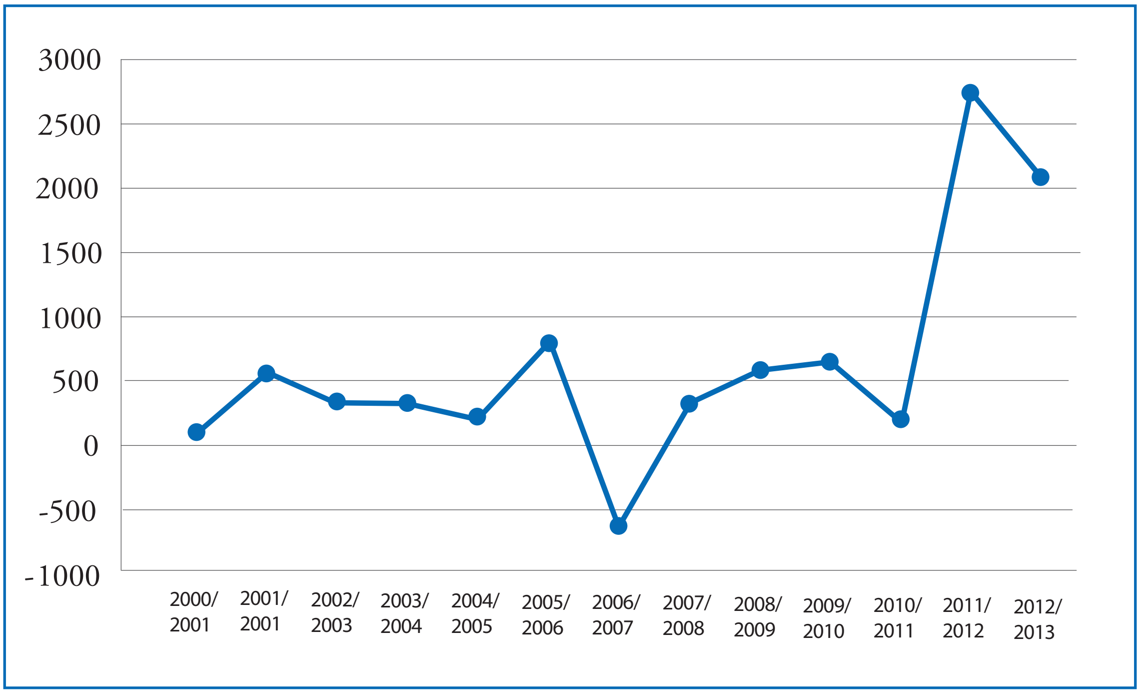
Source: MoFED (December 2013).

2.6 Foreign Direct Investments (FDI)

FDI brings with it technology and knowledge, and for this reason it is regarded as an attractive form of inflows with regard to development. Hence, it is key to cover the gap between domestic savings and investment. Ethiopia has put in place different policies to attract FDI, including duty exemptions and tax holidays.

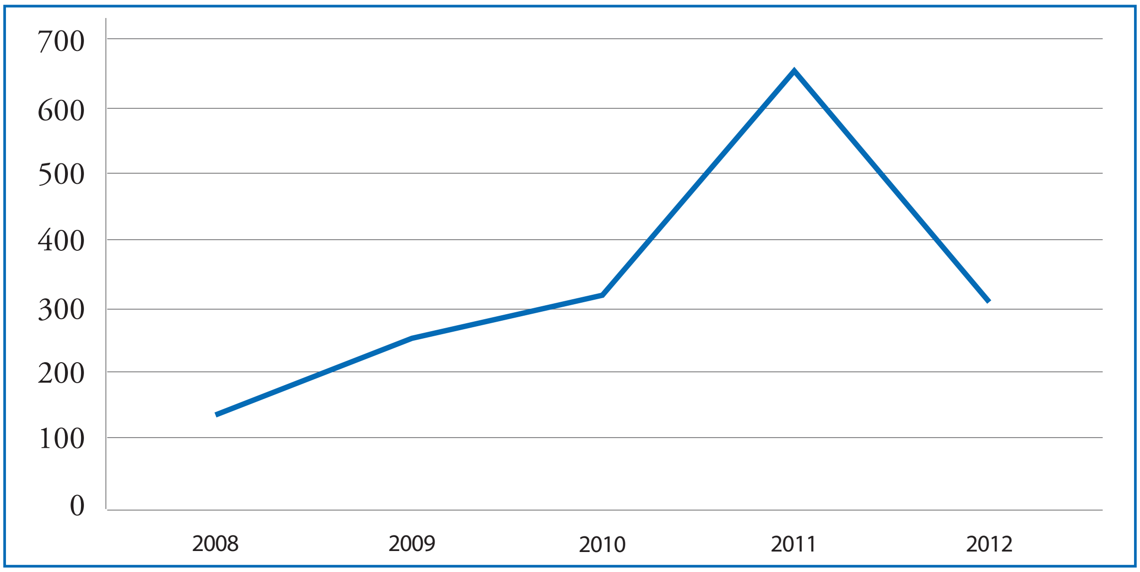
Considering the domestic savings and investment gap in Ethiopia, foreign investment has a very prominent place. Notwithstanding inconsistency in data, it is visible that there was an upward trend in the inflow of foreign direct investment, which also seems unaffected by financial crisis in the developed countries. The country has received USD 4.2 billion in FDI between 2001 and 2012, which is 2.6 percent of GDP on average, but the share was lower in the last five years. (World Bank, WDI) The FDI flow to Ethiopia is still low compared to sub-Saharan African average both in absolute terms and as a percent of GDP (3.3 percent).

Fig 8. Savings-Investment Gap (in USD millions)



Source: Calculated based on National Accounts (MoFED)

Figure. 9. FDI Inflows (in USD millions)



Source: World Bank (WDI database)

Table 5: FDI inflows

	2007	2008	2009	2010	2011	2012
Foreign direct investment, net inflows (USD millions)	222.0	108.5	221.5	288.3	626.5	278.6
Foreign direct investment, net inflows (% of GDP)	1.2	0.4	0.8	1.1	2.1	0.7

Source: World Bank, WDI

According to the Ethiopian Investment Agency, the inflow of foreign direct investment (FDI) has increased over the last twenty-one years. Out of the total investment projects licensed between 1992-2012, FDI's share is about 15.8 percent. However, the licensing rates for FDI are high compared to the projects that actually reach the operation and implementation stage. So it is more useful to look at the projects that have started operations to get a better picture. A total of USD 4.5 billion worth of FDI projects have been operationalized between 2001 and 2013.

The sectoral concentration of FDI varies slightly each year. Generally, however, the attention to the manufacturing sector is very visible: 98 percent of the FDI in 2013 and 50 percent between 2001 and 2013 was directed to the manufacturing sector. The share of agriculture averaged 20 percent and construction and contracting services averaged 15 percent between 2001 and 2013. The share of investment in real estate averaged 10 percent between 2001 and 2013, with intermittent peaks (e.g. 65 percent in 2011).

Looking at the focus of the domestic investment, including where the government expenditures are channeled, FDI is playing an important role in filling the gap in the manufacturing sector. The focus on the manufacturing sector is the result of a deliberate policy action by the government that incentivizes foreign firms investing in the area. The government provided incentives like custom duty exemption on the import of capital goods and tax holidays up to seven years. However, the share of manufacturing sector in GDP has not improved in the past decade, inching up from 4 percent in 2003/04 to 4.2 percent in 2012/13.

2.7 The Role of Remittances

Remittances inflow to Ethiopia has been increasing, registering 7.4 percent annual average growth in the past five years. Especially in 2012/13 the country received USD 2.5 billion in private remittances, showing 28 percent increase compared to the preceding year. The private remittance flows to households and mainly stimulates consumption and serves as a means of acquiring assets like homes. This is because of limited financial investment opportunities available in the country and the amount of remittances being low considered individually, that they could only be invested on real estate and other durable assets or increase consumption. Hence, remittances contribution to GDP is noticeable; remittances share as percentage of GDP averaged 5.7 percent in the past five years.

Table 6: Remittances inflow to Ethiopia

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Remittances (In million USD)	1779.7	1812.3	1843.3	1886.3	1945.9	2491.3
Remittances (% of GDP)	6.7	5.5	6.3	6	4.6	5.3

Source: National Bank of Ethiopia, Annual reports

Furthermore, looked at from country perspective, the remittances that come through the banking system are one of the major financers of the current account. Foreign exchange earnings from remittance flows have recently grown more rapidly than export earnings. Given that earnings from exports cover only around 28 percent of the total import bill, the role of remittances in narrowing the balance of payment gap is significant. Remittance inflows to the country are directly related to the number of Ethiopians working abroad with main sources being USA (34.5%), Israel (15.7%) and Sudan (11.2%). The impact of more than 150,000 Ethiopian returnees from Saudi Arabia, which shares 5 percent of the source market, is yet to be seen.

2.8 The Role of External Public Debt

External borrowing is one of the major avenues Ethiopia is using for financing its development both for the central government and state-owned enterprises. The central government finances a majority of its huge infrastructure projects with external borrowing. Public enterprises like EEPCO and Ethio-Telecom are also increasingly relying on external debt.

The ratio of debt disbursement to total domestic revenue increased from 14.5% in 2006/07 to 20.9 percent in 2012/13, showing the increased importance of external borrowing. This has mainly to do with increased access to borrowing by public enterprises, both government and non-government guaranteed.

The total outstanding debt of Ethiopia reached USD 11.1 billion by end of 2012/13; central government's share is 61.2 percent while the rest is the debt of public enterprises (15.4 percent government guaranteed and 23 non-government guaranteed). The federal government debt has been growing by 22 percent per annum on average in the past six years. Given the significant growth in GDP, the debt to GDP ratio remained at an average of 20 for the past five years. The share of non-government guaranteed debt by the public enterprises has significantly increased from USD 281 million to USD 2.6 billion in 2006/07 in 2012/13.

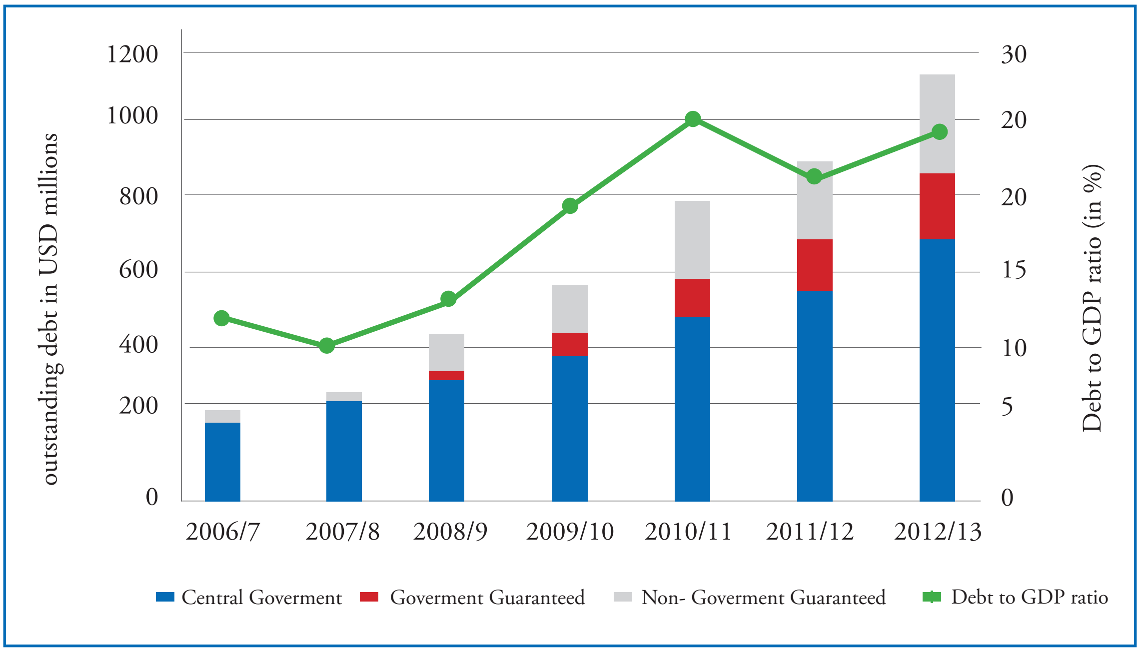
Table 7: Public Sector External debt by lender category

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Official Creditors	2,000.00	2,492.00	3,236.60	4,152.30	5,444.70	6316.4	7,995.70
Multilaterals	1,193.10	1,540.50	2,032.30	2,737.30	3,589.90	4034.1	5,003.80
Bilaterals	806.90	951.50	1,204.30	1,415.00	1,854.70	2282.3	2,991.90
Paris	367.60	456.50	466.00	429.10	468.50	408.1	401.20
Non-paris	439.30	495.00	738.30	985.90	1,386.20	1874.2	2,590.70
Private Creditors	314.60	275. 00	1,115.60	1,481.00	2,362.90	2572.3	3,121.50
Commercial banks	283.80	244.40	217.70	259.20	926.00	1213.60	1747.20
Suppliers	30.80	30.70	897.90	1,221.80	1,437.00	1358.7	1,374.40
TOTAL	2,314.60	2,767.10	4,352.20	5,633.30	7,807.60	8888.7	11,117.20

Source: MoFED, quarterly debt statistics

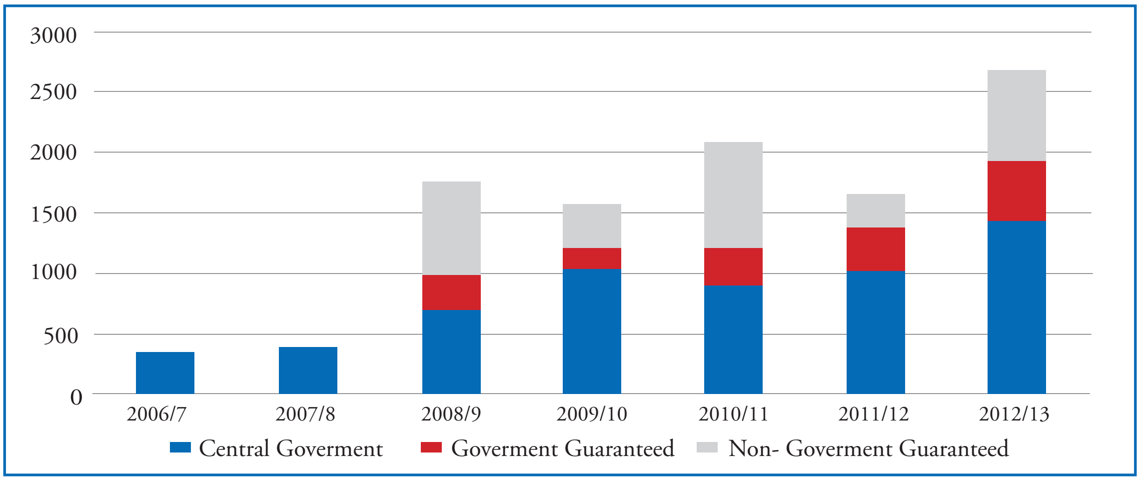
The annual total loan disbursement has generally increased in recent years on account of increase in both credit to the central government and public enterprises, mainly the non-guaranteed component. The highest disbursement is observed in 2012/13, which is USD 2.7 billion, mainly due to high central government borrowing.

Figure. 10. Total outstanding debt in USD millions



Source: MoFED, quarterly debt statistics

Figure. 11. Total annual disbursements in USD millions



Source: MoFED, quarterly debt statistics

As the major debtor is the central government, a majority of the loans originated from official creditors that include bilateral and multilateral organizations. The majority of the bilateral loans belong to the non-Paris club and IDA (World Bank) which is the major creditor from the multilateral side. The share of the non-Paris club creditors - which include China, India, Kuwait Fund and Saudi Fund - have increased significantly, while the share of Paris Club lenders [4], has been shrinking constantly to reach 23.3 percent of total debt in 2012/13. Private creditors that include supplier's credit and credit from commercial banks constituted 28 percent of the total outstanding debt. The supplier's credit component is mainly related to imports of the Ethio-Telecom and EEPCO.

Table 8: Annual disbursement Total versus Non-Paris club creditors (million$)

	2008/09	2009/10	2010/11	2011/12	2012/13
Total Disbursements	1,750.20	1,564.50	2,081.50	1,650.40	2,679.10
Non- Paris Club	251.24	252.66	404.86	514.64	770.38
China	183.47	168.84	299.38	371.59	658.89
India	53.56	73.85	84.92	127.19	102.09
Kuwait Fund	8.32	6.15	16.39	14.19	8.56
Saudi Fund	5.89	3.82	4.17	1.67	0.85

Source: MoFED, quarterly debt statistics

4 The Paris club creditors to Ethiopia with regard to active debt treatments include: Austria, Belgium, Finland, France, Germany, Italy, Japan, Russian Federation, Sweden, United Kingdom, United States.

Most of the multilateral debt is concessional, and similarly bilateral disbursements were mainly ODA to the central government, but also include some non-concessional loans to government-guaranteed enterprises. The supply of credit from private sources has substantially increased in recent years (2008/09-2012/13), and this is the sole source of the non-government guaranteed enterprises. This happens mainly through trade links as the majority is from suppliers while credit from commercial banks has also become unreasonably high.

As for the purpose of the loans, projects took the higher share in all the three categories (central government, government guaranteed enterprises and non-government guaranteed enterprises), indicating that the majority of the loans are tied to specific set of activities aimed at the development of an economic sector. Debt reorganization is the second most important purpose for central government borrowing, followed by programme (a type of direct allocation for which there is a programme to account for it), which has also become important the borrowing by government-guaranteed enterprises. Imports are the second main purpose of loans after funding projects for non-government guaranteed enterprises sector.

Most of the loans went to finance infrastructure, mainly transport, communications, electricity, gas and steam, and highway transport. Since 2009/10, the Protection of Basic Services (PBS) programme has been taking a large share of the total loans, as well as by some bilateral grants channeled through the World Bank. (In the latest national budget, grants and loans for PBS account for around 30% of ODA on budget.)

In summary, Ethiopia relies on external borrowing to cover the savings-investment gap. Over the last 7 years, the annual loan disbursements to Ethiopia were two and half times the FDI inflows. This could be partly explained by the fact that most of the investments are happening in productive sectors such as infrastructure, which is mainly undertaken by the central government and public enterprises. The debt from the multilateral sources is mainly concessional; nonetheless, lending by the Paris Club countries has significantly declined in recent years while there is an increased importance of the non- Paris club lenders, mainly China, whose annual disbursement increased from 1.9 percent in 2006/07 to 24.6 percent in 2012/13 of the total annual loan disbursement.

Summary

The analysis on domestic resource mobilization, ODA flows, and other financing demonstrates that the Government is drawing from multiple sources of financing to implement the GTP. The domestic sources of revenue are mainly used to fund the recurrent budget (40 percent) and development budget (60 percent), respectively. The budget is further augmented by donor component of the resources with a total of USD3.3 billion disbursed to Ethiopia in 2012. This ODA is mainly directed to basic social services with investments in health and population policies accounting for close to one-quarter (23 percent) of total development assistance. The United Nations contributed about USD 198.3 million, mainly on and off budget support with UNICEF, WFP and UNDP as major donors. The non-traditional donors, particularly China and India, are important sources of financing Ethiopia's development in the areas of infrastructure as depicted on Table 3.

While both donor and government resources are used to support the GTP, there is likelihood of crowding out of both the social and private sectors due to heavy public investment in infrastructure. The government is using external borrowing as one of the major avenues for financing its development both for the central government and the government enterprises. The ratio of debt disbursement to total domestic revenue increased from 14.5 in 2006/07 to 20.9 percent in 2012/13, showing the increased importance of external borrowing and this has ramifications on investment in social sectors as well as private sector borrowing. The crowding out of social expenditures (mainly funded by donors and UN) in particular needs redress given implications it has to the MDGs and in addressing the challenges of poverty and inequality. It will be imperative to recommend a prioritization of the budget expenditures within the wider context of macro-economic management but also to ensure the ring fencing of the social expenditures that are critical for human development.

Section III: Options for Development Financing

In 2012, the UNDP Ethiopia country office commissioned a study to explore prospects of non-traditional sources of development finance for Ethiopia. The study identified five non-traditional sources among which have been analyzed: issuing diaspora bonds, South- South Cooperation, public-private partnership, tourism, and carbon trading.

In addition to these, there is further scope in securing funding from other instruments such as[5] leasing financing schemes, issuing of Eurobonds, private equity, venture capital, and accessing specialized global funds. Some of the suggested options include the following:

(a) Climate Financing vehicles

The climate financing instruments that Ethiopia could tap into include the Clean Development Mechanism (CDM) for carbon financing; the reduced Emissions from Deforestation in Developing Countries (REDD) mechanism; [6]Green Climate fund and [7]GEF and the [8]Climate Resilience and Green Economy (CRGE) Facility. The study by UNDP indicates that Ethiopia can increase its fiscal space by about USD 140 million annually if it can reduce deforestation by 50 percent. The study underscored the need for government to mainstream carbon sequestration as a clean growth strategy as well as source of financing.

(b) Private equity and venture capital funds

This is an area of great potential and UNDP commissioned a study to lay out a framework on how Ethiopia could proceed towards attracting [9]private equity and venture capital into the country. The pursuit of this model is shaped by the need to provide alternative sources of financing for the private sector development. Potential sectors where private equity and venture capital funds could invest are mainly in agriculture and agro- processing, manufacturing, consumer goods and the service industry. The country must, however, address critical challenges pertaining to the exit/entry strategy of the capital, foreign exchange regulations, financial market regulations and legal framework for such a market.

5 http://chilot.me/2011/08/07/proclamation-no-1031998-capital-goods-leasing-business- proclamation/

6 The Green Climate Fund is the new and additional fund which is decided by UNFCCC parties in 2010. Ethiopia is in the process of accreditation of its CRGE facility to access the fund.

7 Under the GEF (global environment fund) Ethiopia has benefited a lot through its focal institution MEF and implementing agencies UNDP(>90%) , World Bank, UNIDO and UNEP under its specific thematic areas such as Biodiversity , Climate Change Mitigation

8 The CRGE Facility Fund was established under MoFED and includes all the bilateral assistance to the CRGE strategy implementation that aims to reduce about 250 mega tonne of CO_2 from 7 sectors. Some funds have begun flowing to the facility to implement the strategy including from Norway, DFI and Australia.

9 Private equity refers to medium-to-long term private shareholder investment in companies as opposed to public-traded companies. By raising capital from institutional investors, private equity funds typically buy stakes in operating companies.

(c) Public Private Partnership (PPP)

The PPP can be defined as an arrangement between a public body and a private party or parties (including community beneficiaries) for the purpose of designing, financing, building and operating an infrastructure facility that would normally be provided by the public sector (Kwame, 2011). The German Agency for International Cooperation (GIZ), under its partnership framework, defines Public Private Partnerships as common project that private companies and development organizations plan, finance and implement together with the objective of achieving win-win results for both parties. In the Ethiopian context, the PPP modality of financing could contribute to mobilization of capital from the private sector as well as transfer of knowledge and technology. It is important that the government puts in place a conducive legal and policy framework for PPPs to succeed and this is an area that development partners could assist.

(d) Diaspora Bonds

The Government has previously floated diaspora bond to tap on the on the large diaspora around the world. Experience shows that this is a highly feasible source of development financing with the right conditions and financial advisory services.

(e) International Sovereign Bond

The Government has an opportunity to float an International Bond as recent successes in Ghana and other countries would suggest. The Standard & Poor's Ratings Services recently assigned its 'B/B' foreign and local currency long and short-term sovereign credit ratings to Ethiopia (S&P, 2014). While constrained by low GDP per capita and a lack of monetary policy flexibility, the ratings took cognizant of Ethiopia's political stability, strong government effectiveness, a moderate fiscal debt after debt relief and moderate external deficits

Section IV: Recommendations/ Suggested Next Steps for the UN

The government of Ethiopia has utilized both fiscal and non-fiscal instruments to mobilize resources to finance its recurrent and development priorities as set out in the GTP. The analysis overall shows a prudent fiscal management of the resources and a well-balanced macro-economic priorities of low inflation and low fiscal deficit. However going forward there is absolute need for a more nuanced policies that takes to account the narrowing of options for financing the ambitions of the GTP and changing aid landscape. In this regard, the UN has a role to engage with the Government on the following ideas:

a. Encourage the government to direct investment to more productive sectors of the economy that have a higher return on employment and wealth creation. The private sector for example provides best opportunity cost as it releases untapped sources of growth in diverse sectors of the economy. This includes facilitation of manufacturing sector, which has not been expanding fast enough through forward and backward linkages with other sectors of the economy.

b. While the analysis shows that the budget may have over the past years been increasing in nominal terms, it has actually declined if compared as a ratio of the GDP. The UN can call for scaling up of the budget in real terms especially in social sectors that have a greater impact on the MDGs and inclusive growth.

c. The UN can advocate a balance between investing in infrastructure, which takes a large share of capital budget, and financing human capital. This means scaling up of budgetary allocations and targeted donor support in critical areas of education and health that have a bearing on quality assurance.

d. The FDI flows have not matched the double digit growth experienced over the last decade and as a share of GDP been averaging 2.6 percent compared to the sub-Saharan average of 3.3 percent. The UN can call for improvements in the business environment in order to make Ethiopia an attractive destination.

e. The public external debt has been increasing over the last 5 years with central government as the major debtor. The 2014 IMF Article IV consultations indicate a manageable debt sustainability ratio but nonetheless this could pose a challenge in the long-term if current trends remain unchecked. The UN can help alert Government to this danger.

f. Need for the UN to strategically position itself to assist Ethiopia in taking advantage of opportunities for raising finance for development presented by the changing global environment. The rise of the South and foundations such as the Bill and Melinda Gates Foundation can be new anchors of partnership that could be leveraged in financing development.

REFERENCES

- CSA Database
- Development and poverty in Ethiopia (1995/96-2010/11)
- MoFED (December 2013), "Ethiopia EFY 2005 Annual Statistical Bulletin on Official Development Assistance (ODA)", Addis Ababa.
- OECD (2014), DAC aggregates and Creditor Reporting System, Paris, France
- Prizzon, Annalisa and Andrew Rogerson (2013), "The age of choice: Ethiopia in the new aid landscape", Overseas Development Institute (ODI), London.
- Ethiopia EFY 2005 Annual Statistical bulletin on ODA
- Ethiopia External Debt Bulletin
- Government of Ethiopia, Annual Progress Reports on GTP, 2014
- Government of Ethiopia, Federal government budget statements, 2005/06 -2014/15
- Government of Ethiopia, Growth and Transformation Plan (2009/10-2014/15)
- Kwame A. Asubonteng, 2011, Capacity Building and Public Private Partnership Planning and Implementation, November 2011, Addis Ababa
- MOFED Database (Fiscal and National Accounts) 2012/13
- National Bank of Ethiopia. Annual and Quarterly Bulletin various issues
- UN, 2011, UNDAF Action Plan (2011-2015)
- UNDP, 2013, towards a framework for Attracting private equity and venture capital in Ethiopia, No. 3/2013

Contributors:
James Wakiaga, Emily Bosch, Haile Kibret and Roza Mamuye. Policy Advisory Unit, UNDP Ethiopia